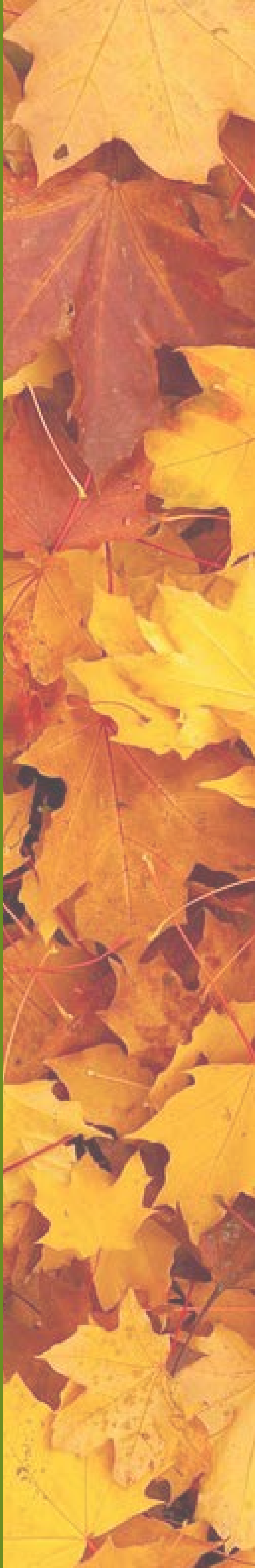
CENTER FOR REAL ESTATE

QUARTERLY REPORT

3rd Quarter | Fall 2022



A publication of Portland State University's Center for Real Estate

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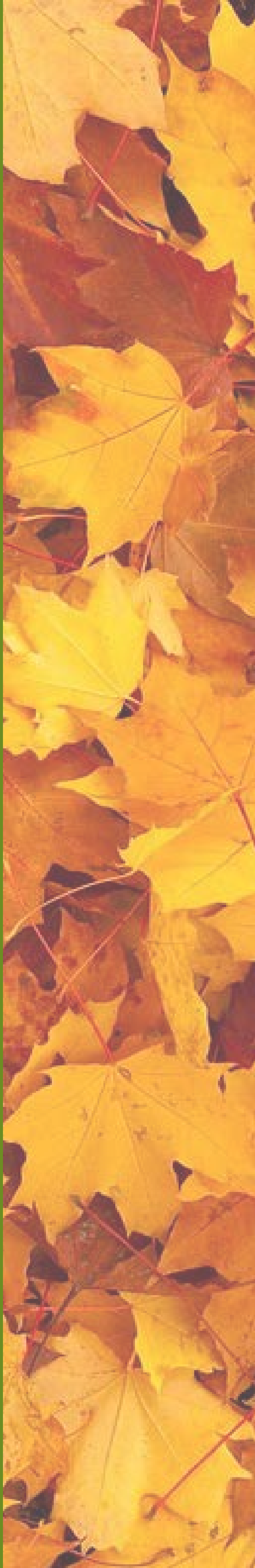

01

INSIGHTS

2022 Q3 Residential Report & Critiquing Portland's Inclusionary Zoning Policy

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Portland State University

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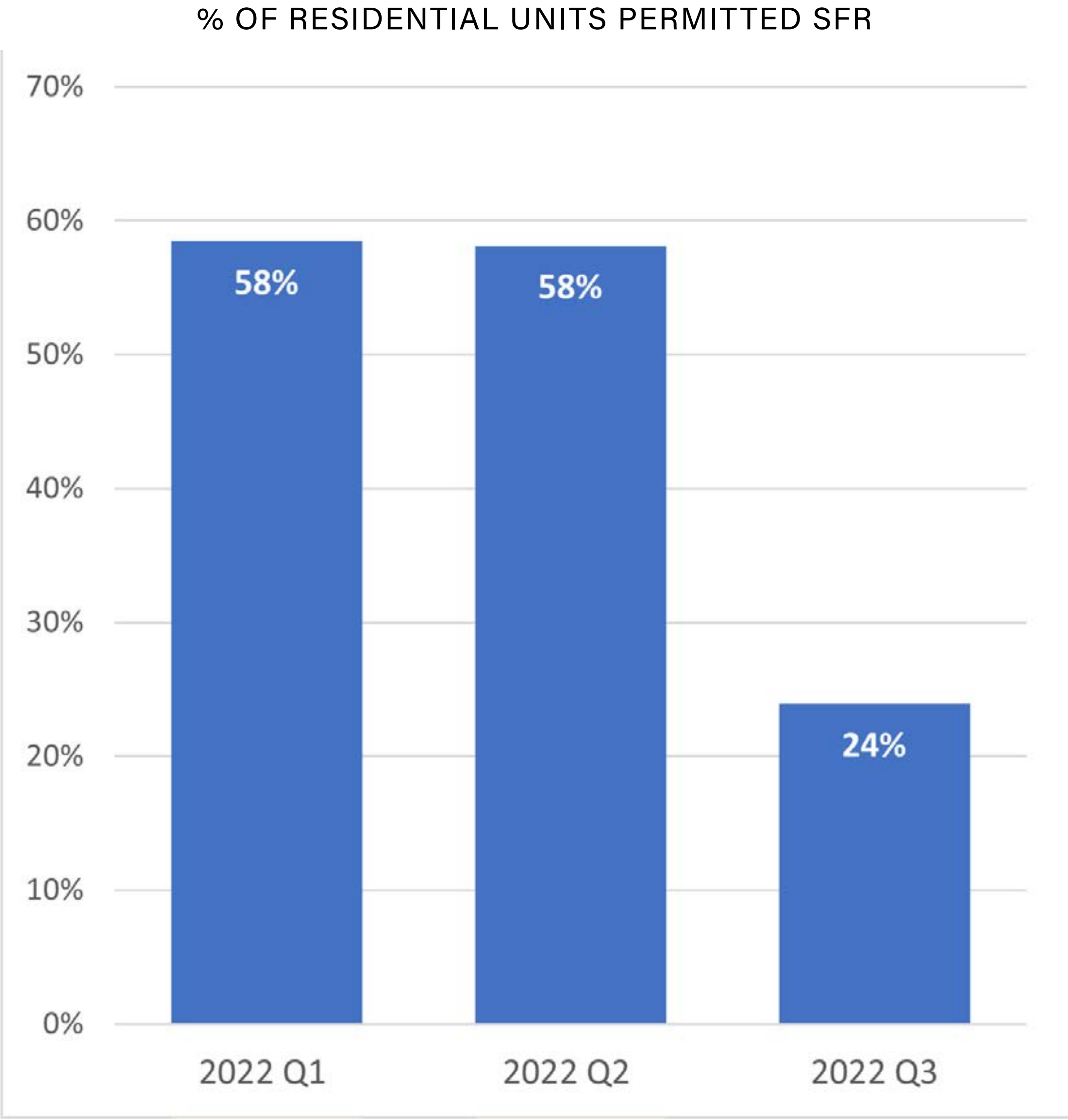
HUD

2022 Q3 HOUSING PRODUCTION SUMMARY

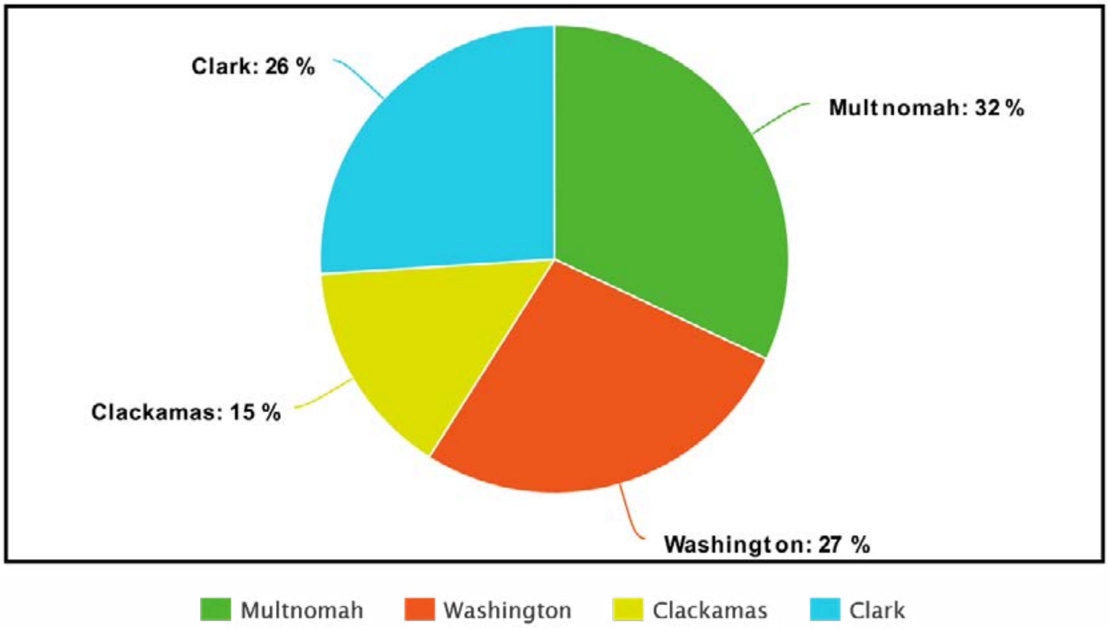
Overall, numbers for the third quarter reflect a strong market and a notable increase in multi-family permits with a drop in single family housing production across the region (defined as Clackamas, Clark, Washington, and Multnomah counties). Comparing regional permit volume from the second and third quarters, we see an overall increase in the number of residential permits from 2,656 to 3,892, but a significant reduction in single family permits, from 1,544 in the second quarter to only 952 in the third. As a percentage of the overall volume, single family residential permits fell from 58% to 24%.



Big picture regional volume shows Multnomah County leading for the first time this year with 32% of overall residential permits. Washington County follows closely with 27%, then Clark County at 26%, and finally Clackamas County with 15%.

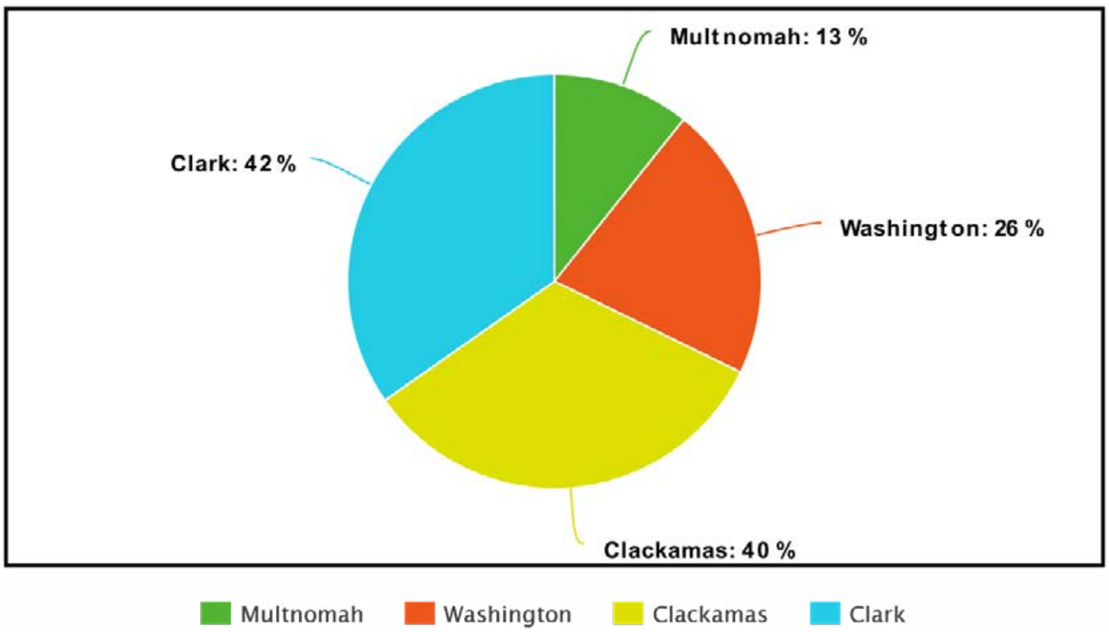
SCODS Building Permit Database

REGIONAL RESIDENTIAL PERMITS



SCODS Building Permit Database

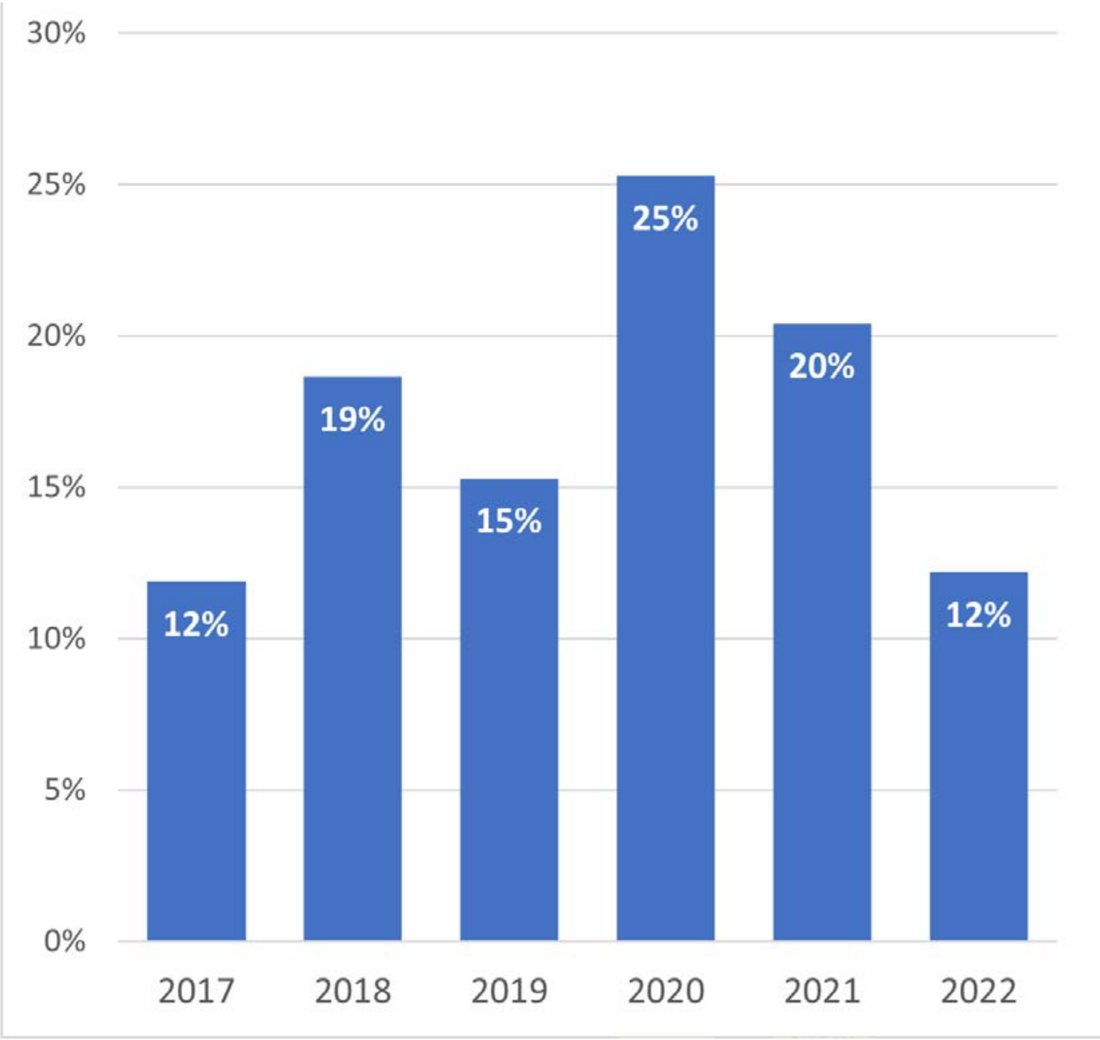
REGIONAL RESIDENTIAL PERMIT VOLUME



Breaking down the permit numbers by type, we see a dramatic decline in Multnomah single family residential permits, dropping from 43% in the second quarter to only 13% of residential permits in the third quarter. This represents a running YTD share of 25% of total residential permits, a slight increase over the previous five years.

HUD

% OF RESIDENTIAL PERMITS SFR - MULTNOMAH COUNTY

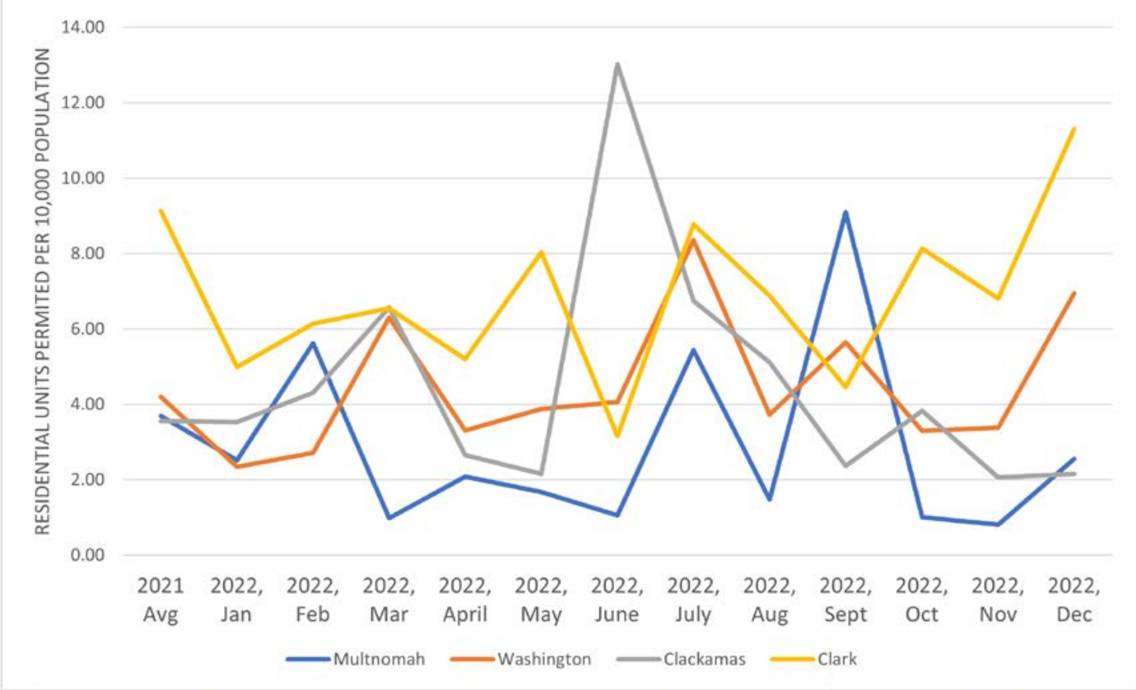


Washington County also experienced a reduction in the third quarter (26%) compared to the second quarter (75%), while still seeing an increase in the overall annual volume YTD of 71% compared to 2021's 64%. Clackamas County, on the other hand, shows a drop in both quarterly and annual single family permits. In 2021, single family residential represented 70% of the overall permit volume, while in 2022 the YTD share is only 46%. Similarly, in Clark County we see a decrease of single family permits from 76% of the overall volume to 42%, but the 2022 YTD volume of 74% represents an increase from 2021, which only had a 57%. Once again, Clark County represents the region's largest percentage of overall residential volume, and the highest rates of single family residential permits as well.

In looking at the numbers per 10,000 residents we see a stronger showing this quarter than the last in Multnomah County, with 16.02 permits/10,000, an increase from the second quarter's production of only 4.8. Washington County maintained a slightly higher ratio with 17.7/10,000, an increase over the second quarter output of 11.2. Clackamas saw the lowest volume, with only 14.2 per 10,000 residents, down slightly from the previous quarter's output of 17.8, and Clark County represented the highest ratio, with 20.12 new residential permits per 10,000 residents.[1]

1 *Office of Policy Development and Research. SOCDS Building Permits Database, accessed November 1, 2022.*

RESIDENTIAL PERMITS PER 10K BY COUNTY/MONTH



So, while overall local numbers represent a much needed increase in production, we are still greatly under-producing housing. In the past twenty years Oregon has failed to meet housing demand, and as a result, our housing stock is underbuilt by an estimated 110,000 units[2], which means our communities continue to face a very real housing shortage. When a commodity market is driven entirely by supply and demand, in this case with a guaranteed demand for shelter and very limited supply, the cost of housing rapidly escalates. In a housing supply constrained market, people in the lower income brackets are unable to compete and experience greater housing insecurity and homelessness as a result. A lack of homes is a direct cause of our state's rise in homelessness[3].

ISSUES OF HOUSING AFFORDABILITY FOR RENTERS

If you are renting your housing unit today, data shows that you are paying a higher percentage of your income towards rent than you did just ten years ago. When adjusted for inflation, renters in the US today , while making slightly more than they did five years ago, earn less than they did in 2001, making housing costs more and more unaffordable[4].

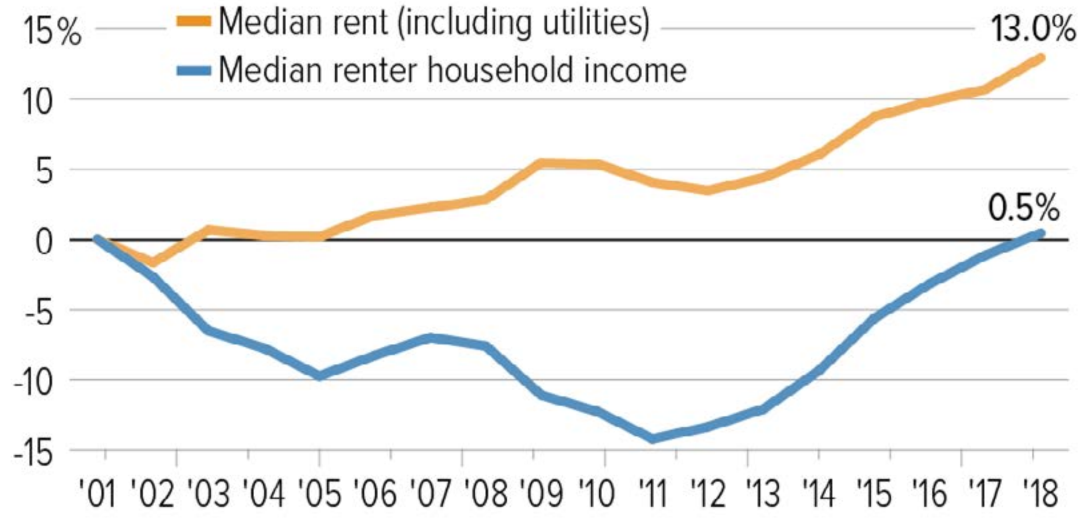
2 *Josh Lehner. "Construction, Housing Supply, and affordability," Oregon Office of Economic Analysis, February 15, 2022, https://oregoneconomicanalysis.com/2022/02/15/construction-housing-supply-and-affordability/*

3 *Blair Best. "A new study says the housing market is largely to blame for Portland's homeless crisis," KGW, July 20, 2022, https://www.kgw.com/article/news/local/homeless/new-study-housing-market-root-cause-homelessness/283-819457a7-9606-42c6-9cb3-62bd25661d2b.*

4 *Jeff Mapes. "Oregon legislators reach deal on affordable housing legislation," OPB, February 23, 2016, http://www.opb.org/news/article/oregon-legislators-reach-deal-on-affordable-housing-legislation.*

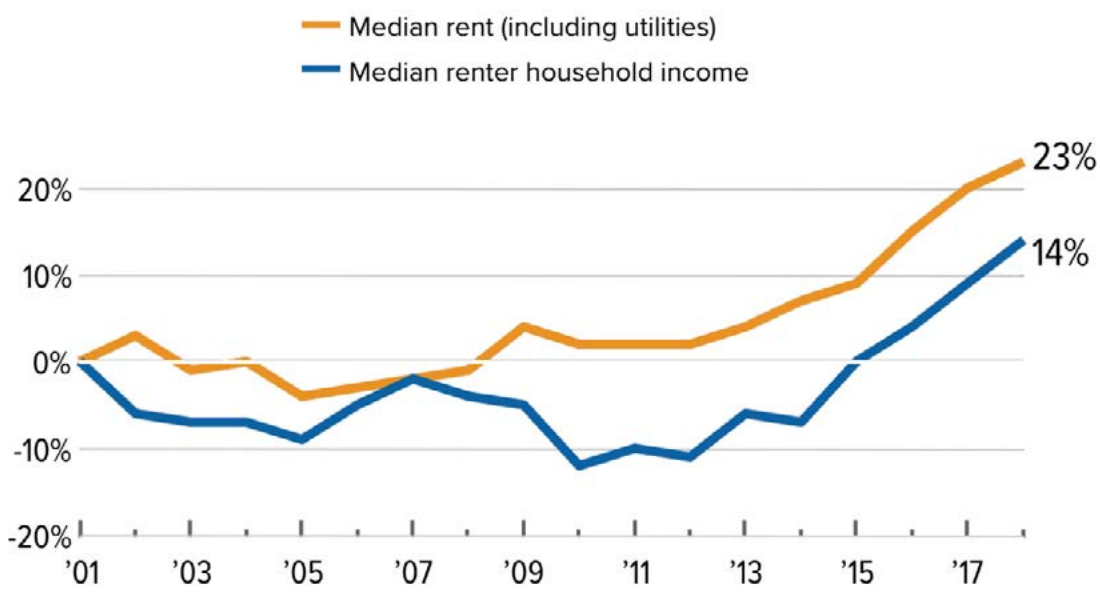
Center on Budget and Policy Priorities | cpbb.org

RENTERS' INCOMES HAVEN'T CAUGHT UP TO HOUSING COSTS PERCENT CHANGE SINCE 2001, ADJUSTED FOR INFLATION.



Center on Budget and Policy Priorities | cpbb.org

CHANGE IN OREGON MEDIAN RENTS AND INCOMES SINCE 2001, ADJUSTED FOR INFLATION



Oregon's overall numbers are slightly better, showing an overall increase in median income of 14%, but with a corresponding increase in housing costs of 23%, compared to only 13% nationwide. So while renters in Oregon today earn more than in 2001, they pay a higher percentage of that income towards rent than they did 20 years ago[5]. When we take a closer look at the East Portland submarket specifically, however, CoStar reports a much higher rent increase over the past 10 years of 47.9%[6].

In 2021, the US Census Bureau found that 51.1% of all rental households in the US struggled to pay their housing costs, with 26% reporting a severe cost burden, meaning they spent more than 50% of their income on housing. This represents a change from the previous ten year trend, as we are once again at the same levels of cost burdened households as we saw in 2011[7]. The renters most likely to be burdened by housing expenses are the elderly (+65) and young adults (<24), with over 60%

5 Alicia Mazzara. "Rents Have Risen More Than Incomes in Nearly Every State Since 2001," Center on Budget and Policy Priorities, December 10, 2019, https://www.cbpp.org/blog/rents-have-risen-more-than-incomes-in-nearly-every-state-since-2001.

6 CoStar. East Portland Multifamily Submarket Report. November 2022.

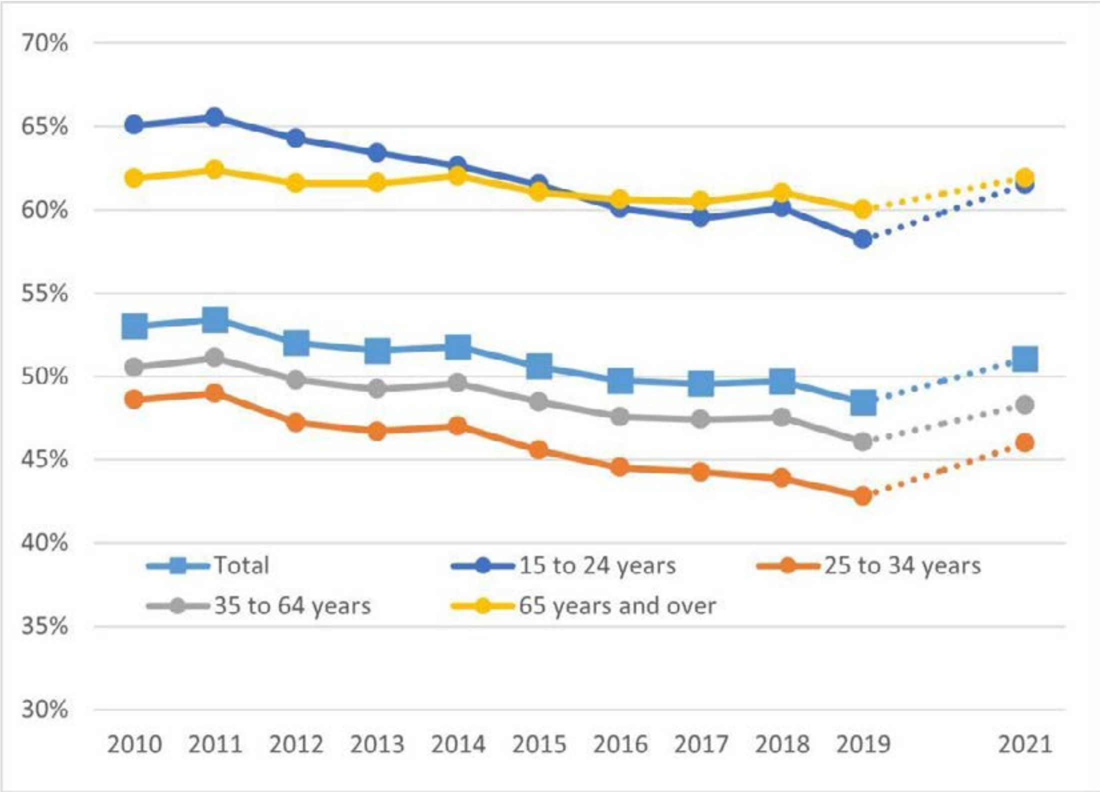
7 Josh Lehner. "Construction, Housing Supply, and affordability," Oregon Office of Economic Analysis, February 15, 2022, https://oregoneconomicanalysis.com/2022/02/15/construction-housing-supply-and-affordability/

saying they spend more than one-third of their income on housing[8]. Financially burdened renters rightly question if anything is being done to help them, but so far the Federal government has failed to provide any real solutions.

U.S. Census Bureau, American Community Survey

SHARE OF RENTER HOUSEHOLDS WITH HOUSING COST BURDENS BY AGE

Note: Scale starts at 30% to better show variation among age groups



LIMITED FEDERAL HELP

Since the Federal Government passed the Faircloth Amendment in 1998, our country lost over 450,000 units of subsidized housing and turned the IRS into the largest provider of funding for new affordable housing through tax credits[9]. Numbers from 2018, however, show that while the IRS provided $49.5 billion in tax credits for direct housing subsidies to renters, it also provided over $85 billion in tax benefits to homeowners, most of whom earn over $100,000/year[10].

"...the Department (HUD) cannot fund the construction or operation of new public housing units with Capital or Operating Funds if the construction of those units would result in a net increase in the number of units the PHA (Public Housing Authority) owned, assisted or operated as of October 1, 1999."

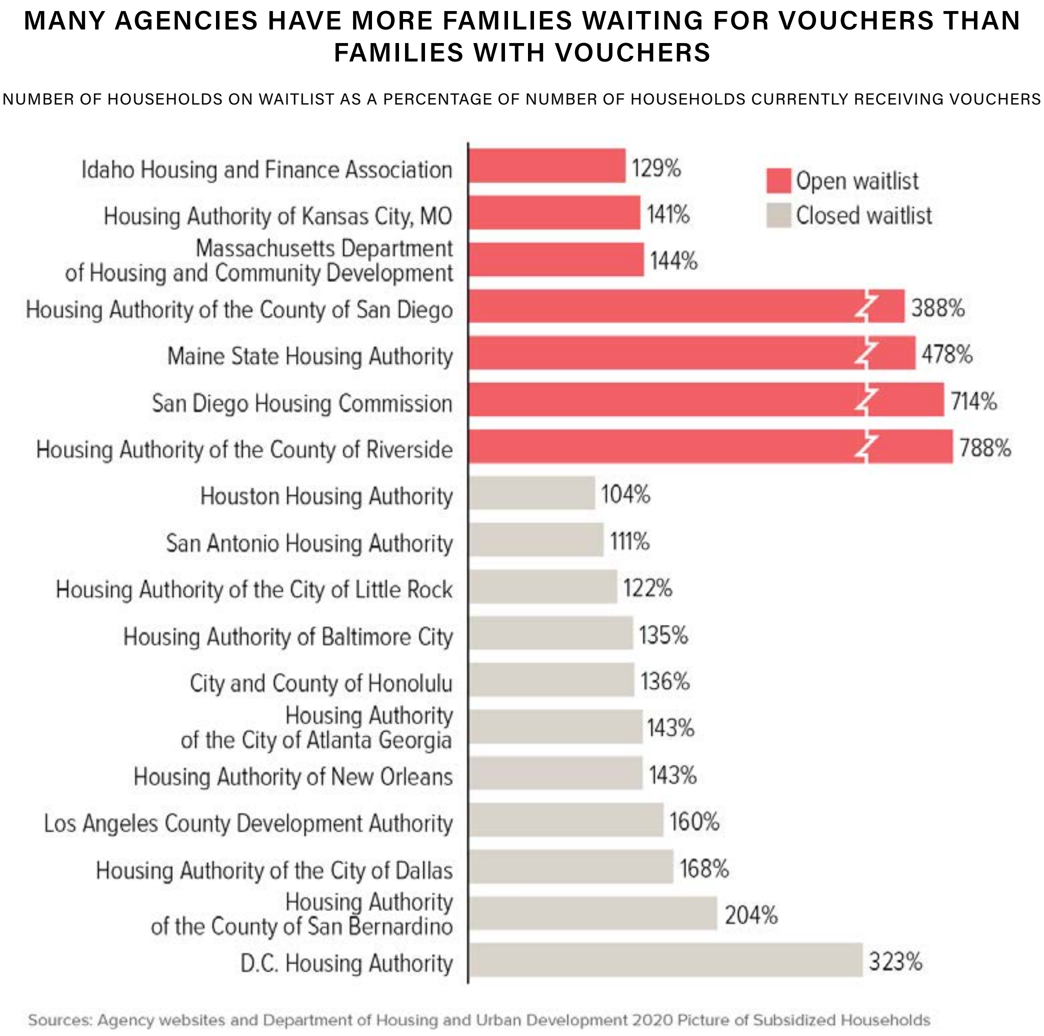
("Faircloth Amendment", Section 9(g)(3) of the Housing Act)

With the supply of public housing arbitrarily limited by the Republican welfare reform policy, the majority of low-income residents are forced to compete for units at market rate. The lucky ones get a housing voucher, but the vast majority do not. First deployed in the 1970's, housing vouchers are a direct household subsidy covering the difference between 30% of the household income and a maximum allowable rent for the area. Despite the promise these vouchers provide, many fail to deliver, as landlords in most states can legally discriminate against a tenant's source of income

8 Rachel Bogardus. "New Census data show growing share of Americans struggling to pay rent," Enterprise Community Partners, September 15, 2022, https://www.enterprisecommunity.org/blog/new-census-data-show-growing-share-americans-struggling-pay-rent.
9 Jared Brey. "What is the faircloth amendment?," Next City, February 9, 2021, https://nextcity.org/urbanist-news/what-is-the-faircloth-amendment.
10 Alex F. Schwartz, Housing policy in the United States (New York: Routledge, 2021).

and thus refuse to rent to someone with a voucher[11]. Across the nation, public housing authorities have years, often decades long waitlists greatly exceeding the number of vouchers available to the housing authority. As a result, most public housing authorities closed their waitlists years ago[12].

Center on Budget and Policy Priorities | cpbb.org



In addition to lackluster new construction, the property tax breaks promised to developers through the Low Income Housing Tax Credits, which expire after 15 years, are the recent cause of many developments converting from affordable to market rate. Municipalities across Oregon struggle to simply maintain the existing number of affordable units in their market[13].

The housing crisis manifests in visible ways as people on the bottom of the bell curve cannot keep up with the rent increases and end up in RVs, cars, tents, or the sidewalk[14]. Local municipalities feel pressured to take action and search for policy solutions as their houseless populations continue to grow. In 2022, states and local municipalities across the country put a record 133 ballot measures to voters that specifically address housing affordability[15]. Many of these initiatives look similar to the Portland Metro Housing Bond, a dedicated stream of tax revenue to finance construction of affordable housing. ("Metro" is the regional government for the Portland Metropolitan Area, encompassing 24 cities over 3 counties). Other ballot initiatives encourage development of affordable housing through changes to the local zoning code. The most commonly used zoning approach is Inclusionary Zoning (IZ).

11 *Andrew Aurand, Dan Emmanuel, Matt Clarke, Ikra Rafi and Diane Yentel. "The GAP: A shortage of Affordable Homes," National Low Income Housing Coalition, accessed October 1, 2022, https://nlihc.org/gap.*

12 *"Policy basics: Public housing," Center on Budget and Policy Priorities, June 16, 2021, https://www.cbpp.org/research/public-housing.*

13 *"Public housing history," National Low Income Housing Coalition, October 17, 2019, https://nlihc.org/resource/public-housing-history.*

14 *Blair Best. "A new study says the housing market is largely to blame for Portland's homeless crisis," KGW, July 20, 2022, https://www.kgw.com/article/news/local/homeless/new-study-housing-market-root-cause-homelessness/283-819457a7-9606-42c6-9cb3-62bd25661d2b.*

15 *Jennifer Ludden. "Voters approved more money for affordable housing around the country," NPR, November 9, 2022, https://www.npr.org/2022/11/09/1135478838/voters-affordable-housing-economy-inflation-2022-midterm-results*

WHAT IS INCLUSIONARY ZONING?

Simply put, Inclusionary Zoning is a reaction to the decades long practice of "exclusionary zoning" in our cities and towns. This practice, though deemed unconstitutional, began dominating local planning and zoning policy with the rise of Jim Crow laws. It successfully reinforced racial, economic, and housing typology segregation by largely prohibiting the development of anything but single family homes for private sale[16]. Although not meant to rectify these years of racial and socio-economic injustice, the intention of Inclusionary Zoning is to increase the number of affordable rental units dispersed throughout neighborhoods, rather than siloed into large scale buildings on busy street corners[17].

In general, inclusionary housing policies are local initiatives that encourage, or outright require, the creation of "affordable" rental units by private developers, often in exchange for increased density or property tax incentives[18]. Across the nation, cities and states create policies that provide a variation on this theme, each resulting in a bespoke product for their specific market needs. Some municipalities, like Portland, allow developers to pay a fee based on the square footage of their building in lieu of offering affordable units.

These policies use HUD's "Area Median Income" (AMI) calculations to establish measures of affordability, with 100% of AMI dividing income earners into halves, those who make above

These policies use HUD's "Area Median Income" (AMI) calculations to establish measures of affordability, with 100% of AMI dividing income earners into halves, those who make above 100% and those who make below. Generally, Inclusionary Zoning policies target households that make below 80% of AMI as the intended beneficiaries of the affordable units[19]. In Washington DC and San Francisco for example, most rental units are targeted to the 50 to 60% AMI range, and for sale units at the 80% AMI range. In Portland, however, developers have the option of targeting the 60% or 80% AMI range for their rental units[20]. While Inclusionary Zoning policies are controversial and generally not viewed favorably by private developers, studies show that municipalities that enact these policies do see an increase in the overall number of residential units built[21].While the potential impacts of these policies strongly rely on regional market conditions and local housing economics, mandatory Inclusionary Zoning policies do not negatively impact the development of new housing[22]. Taking advantage of new construction, regions with strong housing markets reap the most benefits from IZ policies, as developers are more attracted to those investment opportunities.

PORTLAND INCLUSIONARY HOUSING POLICY

In response to Oregon lifting its statewide ban on inclusionary housing policies in May of 2016, Portland quickly started discussions on drafting and implementing one of their own. Their final language stipulates that all permits for new construction of residential development with more than twenty units are required to offer a percentage of those units at rents affordable to households making either 80% or 60% of the AMI. For developments that qualify, 15% of units must be affordable at 80% MFI. If the development is located within the Central City and Gateway Plan districts, 20% of units must be affordable[23].

16 *Richard Rothstein, The color of law: A forgotten history of how our government segregated America (New York: W.W. Norton, 2018).*

17 *Stephanie Reyes. "Inclusionary Housing Policies — 2021 Advocate's Guide," National Low Income Housing Coalition, April 19, 2021, https://nlihc.org/resource/nlihcs-advocates-guide-2021-now-available-online*

18 *Benjamin Schneider. "Inclusionary zoning: Everything you need to know," Bloomberg, July 17, 2018, https://www.bloomberg.com/news/articles/2018-07-17/inclusionary-zoning-everything-you-need-to-know.*

19 *Lisa Sturevant. "Separating Fact from Fiction to Design Effective Inclusionary Housing Programs," National Housing Conference, May 13, 2016, https://inclusionaryhousing.org/resource/separating-fact-fiction-design-effective-inclusionary-housing-programs/.*

20 *Portland Housing Bureau. Inclusionary Housing FAQ. Accessed November 29, 2022/ http://www.portland.gov/phb/inclusionary-housing/faq.*

21 *Lisa Sturevant. "Separating Fact from Fiction to Design Effective Inclusionary Housing Programs," National Housing Conference, May 13, 2016, https://inclusionaryhousing.org/resource/separating-fact-fiction-design-effective-inclusionary-housing-programs/.*

22 *Benjamin Schneider. "Inclusionary zoning: Everything you need to know." Bloomberg, July 17, 2018. https://www.bloomberg.com/news/articles/2018-07-17/inclusionary-zoning-everything-you-need-to-know.*

23 *Portland Housing Bureau. Inclusionary Housing FAQ, accessed November 29, 2022, http://www.portland.gov/phb/inclusionary-housing/faq.*

Portland officials recognized that not all developers, like those involved with the Ritz Carlton downtown, would want to include these populations in their building and can therefore choose to pay a fee instead. This amount goes to the Portland Housing Bureau to supposedly help fund new affordable housing development. In exchange for providing units at affordable rates, the developer receives bonus provisions on building heights and floor area ratios. For developments under 20 residential units, the inclusion of affordable rates is optional. If they opt in, however, they will receive the same bonus provisions for increased density. Policy language also stipulates that IZ units must be at least equivalent in size to 90% of the market rate units of the same type. For instance, developers cannot have an average size, market rate, two bedroom unit be 850 sqft while the "affordable" unit is only 650[24].

Portland Housing Bureau. https://www.portland.gov/phb/income-rent-and-utility-limits

2022 Housing Affordability: Maximum Monthly Rent Including Utilities by Median Income With a Housing Burden of 30% (effective 4/18/2022)

# of Bedrooms	Household Size	30%	40%	45%	50%	55%	60%	65%	80%	100%	*120%*
0	1	$559	$746	$839	**$932**	$1,025	$1,119	$1,212	$1,492	$1,863	$2,236
1	1.5	$599	$799	$898	**$998**	$1,098	$1,198	$1,298	$1,598	$1,996	$2,396
2	3	$719	$959	$1,078	**$1,198**	$1,318	$1,438	$1,558	$1,918	$2,396	$2,875
3	4.5	$831	$1,108	$1,246	**$1,385**	$1,523	$1,662	$1,800	$2,216	$2,769	$3,322
4	6	$927	$1,236	$1,390	**$1,545**	$1,699	$1,854	$2,008	$2,472	$3,088	$3,706
5	7.5	$1,022	$1,363	$1,533	**$1,704**	$1,874	$2,045	$2,215	$2,727	$3,408	$4,089
6	9	$1,118	$1,491	$1,677	**$1,863**	$2,050	$2,255	$2,480	$2,982	$3,727	$4,473

After examining the data available at the time of creation and the data available today of market rate rents and 80% AMI rates, one cannot help but wonder who this policy intended to help, and why we are using AMI as a benchmark for affordability. As data from contemporaneous market studies clearly shows, the market rate for studio apartments across the central city of Portland is below the housing bureau's target rent for 80% AMI of $1,492. Specifically, referencing CoStar submarket reports for the Portland multifamily market in the fourth quarter of 2022, we see studio apartments in the Southeast submarket at $1,260, the Northeast submarket at $1,295, the posh Northwest submarket at $1,163, and downtown studio rents of $1,336[25].

Landlords and developers clearly do not need incentives to offer studio apartments below $1,492/month in most projects[26]. It seems that this policy, instead of providing opportunities for residents to resist displacement or reduce their rent burden, has succeeded in subsidizing gentrification by rewarding developers for building units at rents already at or below "market rate". The policy makers in Portland want you to believe that a single person, earning $59,680 a year (80% AMI for 1 person), requires assistance in affording a market rate studio apartment in the central city.

PORTLAND'S IDEA OF AFFORDABLE

"There is not a county in this country where a worker earning a minimum wage and working full time can afford a two-bedroom apartment," says Tara Raghuveer, an advocate with People's Action."[27] says Tara Raghuveer, an advocate with People's Action.

In 2015, Harvard's Joint Center for Housing Studies released data showing the dramatic difference in 100% AMI for homeowners as compared to 100% AMI for renters. Not only did Portland's 2015 homeowner population greatly outnumber renters (349,400 rental households to 554,500 homeowner households), but they

24 Portland Housing Bureau. Inclusionary Housing, accessed November 29, 2022, http://www.portland.gov/phb/inclusionary-housing.

25 CoStar. East Portland Multifamily Submarket Report. November 2022

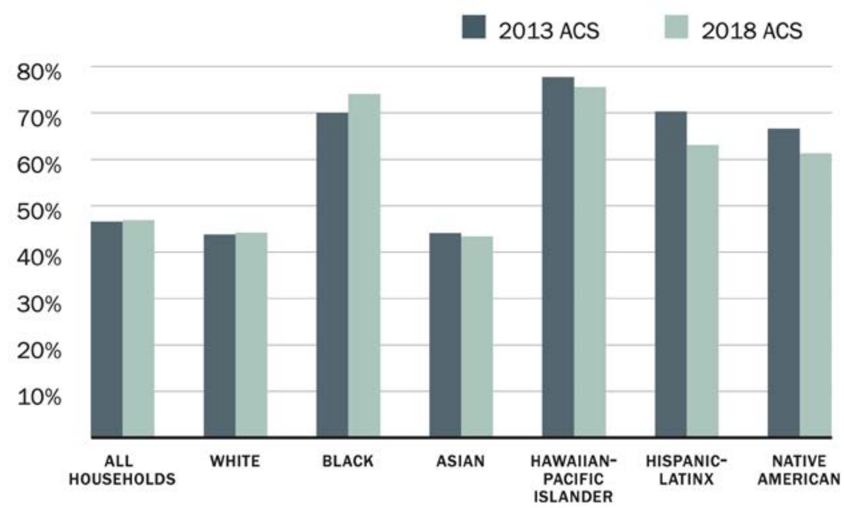
26 CoStar. East Portland Multifamily Submarket Report. November 2022

27 Jennifer Ludden. "Voters approved more money for affordable housing around the country," NPR, November 9, 2022, https://www.npr.org/2022/11/09/1135478838/voters-affordable-housing-economy-inflation-2022-midterm-results.

earned twice as much with a median household income of $81,900 compared to $41,600 for renters[28]. The same held true three years later when the Portland Housing Bureau last analyzed data for their 2020 State of Housing report. In 2018 the median income for homeowners (100% AMI) in the city reached $92,205, a 12% increase, while renters only saw a 2% increase. This means that 100% AMI for renters, at $42,659, is barely 46% of the homeowner median income. And wouldn't you know that communities of color, specifically Black households, experience disproportionately low rates of homeownership compared to White households or the population in general[29]. So while the city of Portland sets the affordability measure at 80% AMI for "affordable" units, the average renter brings home 30% less, putting the 100% AMI for renters at 55% AMI for the city.

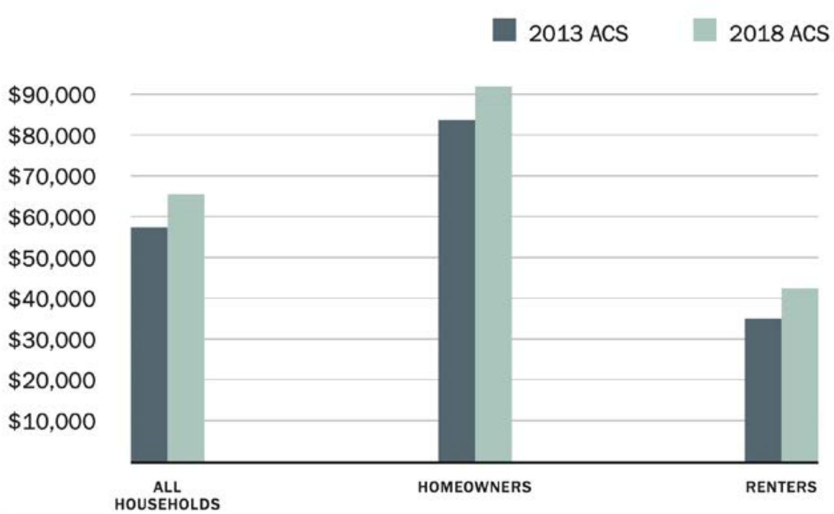
U.S. Census Bureau- 2013 5-year ACS Estimates, 2018 5-year ACS Estimates

Fig. 1.7 Rentership by Race & Ethnicity



U.S. Census Bureau- 2013 5-year ACS Estimates, 2018 5-year ACS Estimates

Fig. 1.5 Median Household Income by Housing Tenure *(2018 Adjusted $)*



28 *"The State of the Nation's Housing." Joint Center for Housing Studies of Harvard University. 2022. https://www.jchs.harvard.edu/state-nations-housing-2022.*

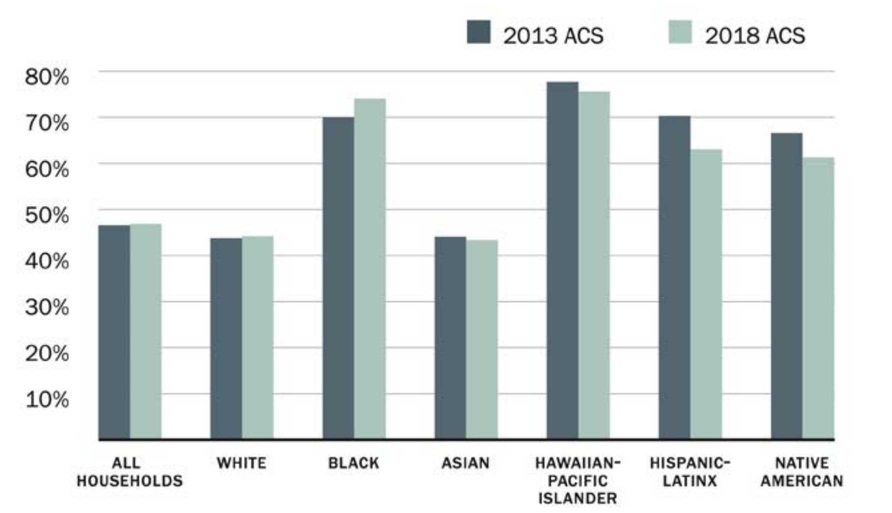
29 *Portland Housing Bureau. 2022 State of Housing in Portland, accessed February 1, 2023, https://www.portland.gov/phb/state-of-housing-report.*

Inclusion of homeowner incomes when determining affordability measures for renters artificially inflates the average income higher than it is represented by the actual rental population. By grouping all the households together, the AMI ignores racial disparities resulting from decades of housing and economic discrimination[30]. Using this metric to determine affordability for the rental population, and most low-income families, hides the true need of our most vulnerable populations, and discriminates against people of color[31]. The Census reports Portland's Black residents constitute less than 6% of the overall population[32]. However, as the graphic from the Portland Housing Bureau shows, Black residents make up more than 70% of the rental population.

With the Black household AMI of just over $30,000 a year, roughly 40% AMI of the general population, we see how subsidizing the development of apartments at 80% AMI ignores the residents most affected by gentrification. The gentrification currently happening in Portland follows a 20+ year trend in the North & Northeast parts of town, the historic "red lined" neighborhoods where Black residents were allowed to live. These areas of town: Interstate Ave, Mississippi Ave, Alberta St, N Williams & Vancouver corridors, Kenton, etc. have seen explosive growth in the 21st century, pushing out the longtime residents as properties increase in value with the influx of new developments and occupants.

U.S. Census Bureau- 2013 5-year ACS Estimates, 2018 5-year ACS Estimates

Fig. 1.7 Rentership by Race & Ethnicity



30 Chris Herbert, Alexander Hermann, & Daniel McCue. "Measuring Affordability: Assessing the 30-Percent of Income Standard," Joint Center for Housing Studies of Harvard University, September 25, 2018, https://www.jchs.harvard.edu/research-areas/working-papers/measuring-housing-affordability-assessing-30-percent-income-standard.

31 "AMI Housing: Deeply Unaffordable for Low-Income Families: Part 2". Defend Glendale & Public Housing Coalition. May 10, 2018, https://www.dgphc.org/2018/05/10/ami-housing-deeply-unaffordable-for-low-income-families-part-2/.

32 United States Census Bureau. American Community Survey (ACS), accessed January 8, 2023, https://www.census.gov/programs-surveys/acs/.

Data retrieved from Portland Housing Bureau. Retrieved November 5, 2022, from https://www.portland.gov/phb/documents/2022-income-and-rent-limits-phb/download

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1	1.5	$599	$799	$898	**$998**	$1,098	$1,198	$1,298	$1,598	$1,996	$2,396
2	3	$719	$959	$1,078	**$1,198**	$1,318	$1,438	$1,558	$1,918	$2,396	$2,875
3	4.5	$831	$1,108	$1,246	**$1,385**	$1,523	$1,662	$1,800	$2,216	$2,769	$3,322
4	6	$927	$1,236	$1,390	**$1,545**	$1,699	$1,854	$2,008	$2,472	$3,088	$3,706
5	7.5	$1,022	$1,363	$1,533	**$1,704**	$1,874	$2,045	$2,215	$2,727	$3,408	$4,089
6	9	$1,118	$1,491	$1,677	**$1,863**	$2,050	$2,255	$2,480	$2,982	$3,727	$4,473

Even if we take race out of the equation and look just at earnings, we see the same curve obliterating the real need. The current minimum wage is $14.75 for the metro area. When calculated for forty hours a week of employment over the course of a year, we arrive at $30,680. So almost 40% (37.8), or more than 1 in 3, of Portland's workforce is considered "very low" income, qualifying as below 45% of AMI, but the city officials chose instead to help the people making 80% AMI.

Portland, OR. Data USA. (n.d.). Retrieved November 5, 2022, from https://datausa.io/profile/geo/portland-or/

Below is but a sampling of studio apartments available in November 2022, all constructed since 2012, on the central east side, with current market rate rents below the 80% AMI subsidized rate of $1492. The current market rate for studio apartment rents already represents what's "affordable" for the 60-80% AMI population. One thing to note, in collecting rental data for the following chart a few newer developments included "income restricted units", these are units mandated by the inclusionary zoning policy. As a general rule they ranged between $50-$150 less than the non "income restricted" units, however, to qualify for these units applicants must show they earn 3x the rent. This is outrageous considering applicants only need to show they make 2x the rent to qualify for the non "income restricted" units. This is a blatant example of landlords intentionally, but legally, undermining the efficacy of this policy.

Sourced from Apartments.com, November 2022

RENTAL INFORMATION FOR STUDIO APARTMENTS IN PORTLAND

Year Built	Name	Rent
2019	Grand Belmont, SE Belmont St	$1,469
2015	Northwood, N Interstate Ave	$1,425
2020	Anthem PDX, E Burnside	$1,335
2022	Division 30, SE Division	$1,325
2016	Cook St, NE Cook St	$1,435
2020	Denizen, NE Hoyt	$1,246
2018	Ava's Place, N Montana	$1,225
2021	Nomad, N Interstate Ave	$1,199
2014	Grant Park Village, NE 33rd Ave	$1,230
2017	The Russell, NE 7th Ave	$1,350
2020	Parallax, N Williams	$1,199
2021	Ascend Apartments, N Vancouver Ave	$1,095
2012	Glee, NE 24th Ave	$1,025
2022	Burnie 2, E Burnside	$999

CONCLUSION

While studies show that Inclusionary Zoning policies do not deter new development, especially in strong housing markets like the Portland metro region, Portland's approach, targeting the 60 to 80% AMI sector that includes income data from homeowners, fails to properly address the issue of true affordability for its rental population. Since, as the current rental listings show, the 80% AMI target of $1,492 is above the average studio market rent for every submarket in the central city, it's obvious that to reach the renters who need help affording current market rents in gentrifying areas we should be aiming for a lower AMI demographic. For an accurate understanding of affordability, renter household incomes should be analyzed independent of homeowner income and separate AMI values established.

Right now the developers are the clear winners, they receive density bonuses and tax breaks to offer units at existing fair market value. Meanwhile, 38% of Portland wage earners fall below 45% AMI, and rents continue to rise faster than the minimum wage. For this policy to offer any real relief to residents at risk of displacement the city should adjust the affordability thresholds down, from 60 to 80% of AMI to 40 to 60% of AMI. This step down would also put Portland in line with other Inclusionary Zoning policies in cities like San Francisco and Washington D.C. with mandatory Inclusionary Zoning affordability measures targeting 60% AMI and below[33].

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02

INSIGHTS

Growing Potential: Mass Timber Furthers Sustainable Future

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This past September the U.S. Department of Commerce's Economic Department of Administration announced an award of $41.4 million to Oregon's Mass Timber Coalition The coalition, made up of multiple agencies and research entities, seeks to promote the use of mass timber in building, promote sustainable forestry practices, as well as develop new manufacturing operations in Oregon and the greater Pacific Northwest. These funds stem from the greater Build Back Better Regional Challenge, a regional economic development competition created by the American Rescue Plan. This influx of federal dollars will allow the Mass Timber Coalition to fully fund multiple projects that remained stalled due to lack of capital. And these projects appear to be necessary to stimulate the use of mass timber in real estate development. With only twenty three projects completed in the United States, mass timber as a building material has not yet been widely adopted by developers domestically.

While mass timber use continues to be popular in Europe (and has been for decades) it is considered a relatively new product in the US market[3]. Several factors contributed to its slow start, including a lack of manufacturers, limited professional knowledge, and strict building regulations that limit its use. However, recent changes to building codes that allow for taller structures, expansion of product offerings, as well as supply chain difficulties in the steel and concrete markets, have pushed developers to rethink mass timber.

"Mass timber" is a collective term for engineered wood products which are manufactured by bonding or laminating smaller dimensional lumber studs, planks, and boards to create larger, stronger structural elements such as columns, beams, and floor systems. Product types include cross-laminated timber (CLT), nail-laminated timber (NLT), dowel-laminated timber (DLT), glue-laminated timber (GLT) technologies, and Mass Ply Panel (MPP)[3].

CLT is a method of layering lumber boards stacked and crossed 90 degrees, and subsequently glued together with structural grade adhesive, creating large structural panels. It is traditionally used as a floor structure, in lieu of concrete or steel decking, and is most often manufactured in an off-site facility. Similarly, nail laminated timber also serves as a mass timber floor structure. Layers of wood members are connected to create a large panel like CLT, but members are stacked face to face and nailed together. NLT can both be manufactured off-site or on-site. DLT is built in the same way as NLT, but uses wood dowels to connect wood members rather than nails. GLT is a method of bonding individual dimensional lumber laminations together in that all lamination wood grain runs in parallel and is often used in column and beam applications (Jackson, et. al., 2017). A newer product called Mass Ply Panel (MPP) is a variation on CLT, composed of multiple layers of wood veneer. It can be used in multiple applications such as wall, floor and roof assemblies.

Even with a wide selection of available products, developers in America still are slow to adopt the mass timber in their new buildings, with only a little over 700 buildings in construction or completed[9]. But now with the new funding from the federal government, researchers will be able to provide better information for developers and architects to choose mass timber in new buildings.

Judith Sheine, Department Chair of OSU's Architecture department, Director of Design at the Tall Wood Institute, a member of the Mass Timber Coalition, and a research collaborator between the University of Oregon and Oregon State University, says the funds from the grant will enable their team to investigate applications of mass timber in innovative ways[10]. Ranging from fire testing, to supply chain analysis and acoustic testing, Sheine notes the federal funds will fill a gap their team struggled to overcome .

Specifically in regards to acoustical testing and analysis, Sheine notes, "There's really no labs to study [mass timber] ceiling and floor assemblies on the west coast. This funding will allow us to build one in order to study sound transmission in mass timber products." She explains that testing and analysis is needed for these types of assemblies, as sound transmission is a major factor in residential development.

While mass timber use in residential buildings is not new, understanding the effects of different mass timber products in floors and ceiling will help build confidence in its performance for developers and jurisdictions concerned about indoor noise control. But studying mass timber use in buildings is one part of the ongoing research that will be sustained through the new funding.

Sheine also mentions that research into sustainable forestry will be a large component to the Mass Timber Coalition work to promote mass timber usage in development. She describes the opportunity to use underutilized species and testing their strength in comparison to douglas fir, the current gold standard of wood construction. The use of low-value species such as ponderosa pine and white pine shows possible applications in various products, allowing for greater diversity in timber harvesting and limiting the strain on douglas fir supply. Other researchers also confirm the sustainable benefits of mass timber beyond better forestry practices through its inherent lower-carbon footprint relative to concrete and steel.

The environmental benefits of mass timber construction are well documented. Similarly, the share of negative environmental impact of steel and concrete is also well recorded. Iron and steel production account for approximately 6.7% of global CO2 emissions, while concrete production accounts for 4-8% of global CO2 emissions [8, 14]. Not only does concrete largely contribute to global emissions, it is also responsible for 85% of all mining, exacerbating the world's depletion of sand[14]. Meanwhile, forests accumulate carbon from the atmosphere, storing it within trees and plants. When wood is harvested, it not only limits the emissions produced from building materials used, but also sequesters carbon from the environment. Some estimates indicated wood stores between 1 to 1.6 tonnes of carbon dioxide per cubic meter of wood. Considering this, wood effectively displaces its own carbon footprint (the embodied carbon from manufacturing and transport is captured within the wood itself).

Additionally, the lower weight of wood, about a quarter that of concrete, results in a smaller foundation, lessening a building's carbon footprint further[1]. In one case study analysis, as described in "The Case for Tall Wood Buildings," the use of concrete in foundations was cut by 44% when the primary structure was replaced with mass timber. Not only did the mass timber positively affect the environmental impact of the building, it also lowered the foundation's construction cost[1]. While inherent qualities of mass timber make it a more sustainable material choice, additional research also shows its comparative life-cycle benefits relative to concrete and steel.

Researchers at the Beijing Forestry University and the US Department of Agriculture Forest Services, performed a comparative life-cycle assessment of mass timber and equivalent steel reinforced concrete[4]. Framework, a proposed 12-story CLT building, was used as a case study, with computer modeling to perform the analysis. The mass timber version of Framework weighed 50% less than its modeled concrete counterpart, limiting the amount of concrete required for the foundation. Considering its lighter weight, mass timber was also projected to contribute less greenhouse gasses during construction. Ultimately, the mass timber building embodied 21% less carbon than the reinforced concrete.

While fire codes prescribed more gypsum board to be used in the mass timber building than the concrete alternative, the carbon sequestering of the wood itself offset the impact of the added gypsum quantities. Inasmuch, researchers highlighted the intrinsic carbon offsetting effects of mass timber production. Because forests are expected to be renewed after logging for mass timber construction, their subsequent growth would lead to a reduction in carbon emissions, balancing them out for a mass timber building over the course of its life-cycle. While only a theoretical model to explore the possible environmental impact of construction materials, this study highlights the very apparent need to assess the use of concrete and steel in high-rise buildings, and the potential environmental benefit of mass timber as a replacement. This positive effect on the environment also translates to economic development.

As the demand for mass timber increases, the forest management and timber processing industry stand to benefit economically. In a report published by the Softwood Lumber Board, projections for mass timber (GLT and CLT) consumption show a 60% increase for 2035 compared to current usages[7]. With this projected increase in demand for mass timber, among other softwood products, the forest industry and lumber processing manufacturing expect to greatly expand their workforce. In a 2017 report, OregonBEST analyses determined that an increase of only 5% of CLT and associated mass timber production would create approximately 2,000 direct jobs. An increase of 15% market share could create over 6,000 jobs in Oregon alone[5].

Not only do increases in mass timber consumption promote direct jobs in forestry and timber manufacturing, but also create new jobs outside the timber industry. Through the increase in spending both from the industry and individual employees, analyses indicated that increases in mass timber manufacturing could create as many as 17,300 indirect and induced jobs in Oregon. Gains in employment as projected would also generate a labor income of $1 billion for Oregon residents and state personal income taxes of $33.8 million. Considering the concentration of forestry in rural areas, the project's increase in demand for softwood products positions rural communities to benefit greatly from the boom in mass timber construction. The increase in job growth is promising, and with policies changes, it can become a reality for both our urban and rural communities.

In a case study published in 2020, researchers with the US Forestry Service also analyzed the Framework Building in Portland, but rather focused on its economic impact. The research team evaluated economic outcomes from mass timber usages versus the onesfor use of reinforced concrete in the Framework's structural design. Using a social accounting model (SAM), researchers were able to create a modeling tool that represented 536 industrial sectors and households of varying income levels. Income levels were outlined as low-income (under $50,000 per year), middle-income ($50,000-150,000) and high-income (greater than $150,000)[6]. Results for constructing a mass timber structural frame indicated a total economic impact of $9.17 million, to which "$3.92 million earnings [were] generated by direct employment in the construction supply chain and from inducted purchases of goods and services throughout the Oregon economy[6]." When breaking down the share between household incomes, 40% of high-income households received the aforementioned earnings, middle-income houses 52%, and low-income households 8%.

Because mass timber structural component costs compose a large portion of a building's total cost (38% was estimated for Framework) mass timber greatly affects the economic impact of a building's construction. Comparatively, reinforced concrete only produced $4.90 million dollars for the Oregon economy. Much of this is due in part to the significant amount of reinforcing steel rebar required for concrete frame construction. Steel is predominantly produced outside of Oregon, thus sending a large amount of construction costs, and economic benefit to other states. Mass timber, on the other hand, required more localized industries like commercial logging, sawmilling, and engineered wood manufacturing, resulting in more regional economic impact for buildings using mass timber structural frames. Given the localized nature of timber production, and forests covering much of the Northeast and Southeast, Northwest mass timber presents the opportunity for strong local manufacturing and production with US markets. But even with all the benefits to the environment and opportunities for rural economic growth, mass timber still remains limited in its use. However, choice developers continue to bet on it for their buildings.

Real estate developer Noel Johnson, spoke of the benefits of mass timber in his developments, having completed four mass timber projects over the past decade. While data suggests that mass timber building costs upwards of 26% more to construct than concrete alternatives, Johnson highlights their market appeals as a means to convince other developers to use the product[2]. He says, "We know that mass timber helps a building lease-up faster, whether it's commercial or residential, it gives greater market appeal[11].” This appeal translates to reaching possible tenants from all walks of life, from coastal liberals who praise its sustainable qualities, but also conservatives who both appreciate its aesthetic quality and its made-in-America status, Johnson elaborates. Additionally, he notes the success of his Clay Creative project, completed while working with Killian Pacific, which weathered the COVID-19 induced impacts to the office market.

Located in the Central Eastside Industrial District of Portland, the Clay Creative was delivered in 2015 and used NLT and GLT mass timber assemblies for its structural system[12]. The project was underwritten on a “gut feeling” about what the existing office market was missing, and had essentially no comparables to judge its assumptions accurately. With significant broker and lender skepticism, it still managed to secure a fast lease-up with top-of-the-market rents and a sizable anchor tenant. Market rents at the time were estimated at $22/RSF/YR, and the projected rent in the initial proform was $24/RSF/YR. The realized rent, however, brokered at $27/NSF/YR upon stabilization. Additionally, the project capitalized on mass timber’s fast construction timelines, allowing tenant improvements to run concurrent to the core and shell construction, ensuring faster occupancy. However, it still saw challenges in the limited knowledge within the design and construction industry, causing change orders and budget overruns. But even with its challenges, Clay Creative attracted a new market share of creative office space and continues to see strong sub-leasing and releasing even amidst high office vacancy rates city-wide. And Clay Creatives’ successful lease up is not unique to the Portland market..

The ICE Blocks in Sacramento, CA, developed by Heller Pacific in 2018, is a redevelopment of a formerly adaptive reuse project that suffered a fire before construction. Mass timber was selected to mimic the industrial qualities of the original building, and the surrounding neighborhood. Additionally, the developers noted mass timber’s unique qualities set it apart from other office developments in the already competitive submarket of Midtown Sacramento, an up-in-coming, walkable neighborhood adjacent to the city’s downtown core. Similar to Johnson and Killian Pacific, Heller Pacific championed the project on a “gut feeling,” even though vacancy rates of 10.4% at the time indicated a high risk of stabilization. The 132,000 SF net rentable building included 100,000 SF of office space and 32,000 SF of retail.

Much like Clay creative, ICE Blocks suffered from a lack of industry knowledge of mass timber. With subcontractors not pricing the project accurately, and cost overruns consuming all of the project’s contingency, the project ultimately cost $367/GSF, approximately 3% higher than initially budgeted. Ultimately though, it paid off for the developer, as realized office rents brokered at $34.80/RSF/YR, $3 greater than what was originally estimated in the proforma, and almost $8 more that market rents at the time. Additionally, office space leased quickly, surprising the project’s sponsor, who said “‘It turns our architecture does matter even in a government-centric city.’” However, retail rents only achieved average market rates at $42.00/RSF.YR, and leased up much slower due to an extremely selective process of choosing tenants.

Even with the mediocre retail performance, the office space lease up, as well as tenant satisfaction, were seen as major successes to both the developer and the broker, who indicated that leasing renewals would more than likely achieve premium rents. With high construction costs, but premium rents and quick lease-ups, projects like ICE Blocks and Clay creative highlight mass timber’s complicated implementation, but also the possibility of a successful future.

With the new funding provided to the Mass Timber Coalition, mass timber is positioned for greater utilization in building production. However, both Judith Sheine of the Tall Wood Institute and developer Noel Johnson mentioned the need for educating architects and design professionals to effectively use mass timber in their designs[10,11]. Johnson specifically highlighted that architects should embrace mass timber’s modularity, as well as its available product offerings, stating, “Architects think the sleek clean look of CLT is better, but users don't know the difference between it and [less expensive] NLT[11]." Even though design professionals and contractors are working to catch up to the new demands of mass timber use, both Sheine and Johnson see mass timber's adoption trajectory similarly to other adopted building features like LEED certification. As further research is conducted and developers' risk tolerance for mass timber lessens, the US stands to see a revitalized timber industry, more sustainable buildings, and highly marketable spaces for tenants. And with this greater investment in mass timber use and production, our cities and forests will reach greater heights in tandem.

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03

COLUMNS

Summary | Return to the Office

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Like most other major U.S. cities, the future of the commercial office market in Portland remains uncertain, as companies continue to evaluate their need for office space in this post-pandemic world. Many local employers, including Nike, Google, and the City of Portland, have expressed their desire to see workers return to the office. However, employees have enjoyed the conveniences of remote work for more than two years, and a tight labor market has made it difficult to compel them to return en masse. Consequently, the suburbs continue to outpace downtown as companies seek smaller, cheaper spaces proximate to their employees.

The pandemic showed us that productivity does not suffer when employees are not in the office because most meetings, tasks, and assignments, can occur anywhere. Furthermore, most workers prefer to work remotely, so getting them back to the office even a couple of days a week has been challenging. According to census estimates, approximately 33,500 people were working remotely in 2019, which climbed to 123,000 in 2021 – an increase of nearly 267%. While only 40% of pre-pandemic downtown office workers have returned to their desks, Portland is faring better than other west coast cities – Seattle, San Francisco, and Los Angeles.

The trend toward remote and hybrid work has forced companies to reevaluate their priorities and the role of the office within the organization. Whether a firm opts for less space in the suburbs or chooses to remain in the urban core, it will need to reimagine and configure the space to accommodate a hybrid work environment. For that reason, we have seen more demand for high-quality office space with access to amenities in both the downtown and suburban markets. These spaces are designed to foster creativity and collaboration, support the type of interactions unlikely to occur in a remote environment, and curate an experience that will attract workers to the office more frequently.

ECONOMY | EMPLOYMENT | POLITICAL CLIMATE

The Portland Metropolitan Statistical Area (MSA) experienced strong economic growth throughout the third quarter amid 40 year high inflation. Gross Domestic Product (GDP) increased at an annual rate of 2.9% compared to a decrease of 0.6% in the previous quarter. The Portland job market also held strong, with the number of nonfarm payroll increasing by 5.4% (63,000) since the beginning of the year and unemployment at a historic low of 3.3%. While the economic environment remains strong, consumers are grappling with inflation levels not seen since the 1980s. To curb inflation, the Federal Reserve Bank raised the effective federal funds rate six times since the beginning of the year to a rate of 4%, its highest level in 15 years.

Costar

Despite the strong economy and increased consumer spending, Portland's downtown has been slow to recover from the effects of the pandemic. The increased crime and homelessness, along with the negative public image brought on by months of protests and social unrest, brought the situation to a breaking point after numerous businesses left downtown and angry business owners and residents in Old Town and the Central Eastside demanded that the city find a solution.

The city took bold actions to address the situation by initiating an unprecedented sweep of homeless encampments in Old Town and increasing police patrol. Portland City Council also passed a series of resolutions to address accessibility and safety concerns. These measures prohibit camping on city streets and sidewalks and call for creating six city-approved camping sites and constructing 20,000 affordable housing units.

SUPPLY | DEMAND

The demand for office space in the Portland market remained low in the third quarter, although it continues to fare better than the nation overall. The suburban submarkets continued to outperform the Central Business District (CBD), and occupied office space declined by 960,985 square feet. Office vacancy rates marked an 11th consecutive quarter of increases but the rate of increase appears to be slowing. According to CoStar data, the office vacancy rate in the overall Portland market was 12.2%. This was 110 bps higher YOY (Q3 2021 –11.1%) but only 10 bps higher than the previous quarter (12.1%).

The gravitation toward quality in the CBD and the suburbs continues as the suburban submarkets outperform the urban core. The vacancy rate of 21.4% in the CBD was nearly three times higher than that in the suburbs (7.8%). Notwithstanding, vacancy rates for four and five-star properties in the CBD are 430 bps lower than three-star properties.

Costar

The trend toward a hybrid work model has resulted in an overabundance of sublet availabilities, reaching a 13- year high of 2.8%. Despite weak demand and rising interest rates, the annual rent growth for the overall market is 2.3% and increased marginally in the third quarter (Q2: $28.68 | Q3 $28.91). This was largely driven by demand in the suburbs, as rents in the CBD declined 1.3% from the previous quarter (Q2: $33.33 | Q3: $32.91). Notwithstanding, rents are forecast to decline in 2023 due to the culmination of new deliveries and anemic demand.

The lack of office users in downtown Portland has not only left the city with a glut of available office space but has also resulted in retail vacancies at the street level from a lack of activity.

While it may not have initially been hit as hard as some gateway cities, the City estimates that 32 buildings downtown are at or above 70% vacancy, so it could be years or even decades before we see a full recovery.

The City of Portland has recently taken measures to address homelessness and improve public safety. The future of downtown office space remains uncertain, but when the dust settles, demand for office space is expected to be approximately 30 percent lower than pre-pandemic levels. While the demand for Class A and trophy office space will recover in the long term, CBD will be left with a surplus of outdated Class B and C space that could be mothballed for decades. For that reason, a full recovery hinges on a reimagined downtown where a significant portion of the existing office space is adapted for another use.

While some surplus space could be converted to flex or co-working space, many cities across the U.S. have successfully conducted office-to-residential conversions. Repurposing office space for housing seems logical, as it could address the housing shortage and increase activity in the CBD. However, deep floor plates can present logistical challenges, and existing office values and rents for some assets would need to drop significantly before such a conversion would be financially feasible.

Nonetheless, Mayor Ted Wheeler's office has introduced an ordinance that would incentivize developers and investors to repurpose offices for workforce housing. Mayor Wheeler's plan would waive one-time development fees associated with adaptive reuse projects, which can be particularly costly for residential conversions.

CAPITAL MARKETS | CONSTRUCTION | DELIVERIES

Cap rates held steady at 6.31% in the third quarter amid rising interest rates. While trade activity was light in the third quarter, some notable transactions included: Unitus Community Credit Union purchased the 89,672 square foot Bridgeport Center in Tigard for $301.10 per square foot and Melvin Mark purchased the 47,000 square foot Alderway building in downtown Portland for $181 per square foot.

The Portland Office Market saw no new deliveries in the third quarter, although two projects in the West End neighborhood of downtown Portland are set to deliver respectively in the first and second quarters of 2023 – the offices at 11W, a 134,135 SF mixed-use project, and the long-anticipated Block 216, the 1.1 million SF mixed-use tower that is home to the Ritz Carlton Hotel and Residences with 158,000 RSF of premium, Class A office space.

CONCLUSION

Evaluating the health of downtown is important for potential newcomers, and the lack of interest in returning to the office may cause a self-reinforcing loop of lost potential as the city core fails to attract new businesses and employees. With a steady stream of growth, the region is still flourishing; the City of Portland remains a top food and tourism destination and maintains a well-educated and skilled workforce. However, despite its history of creative types and innovators flocking to the city, there is little interest in working from traditional office spaces in its once-vibrant core. Still, the city's 200' x 200' grid design, public transit system, and rich bicycle culture make it one of the country's most walkable and livable cities – so if and when employers and employees return to the core, the city will be ready for them.

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04

COLUMNS

Third Quarter 2022 Retail Market

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The demand for retail in Portland during the second half of the year has been in a strong position. As seen in the second quarter, the spread of COVID-19 has dropped along with the restrictions on businesses, allowing for better production in the retail market. The third quarter has seen a brief positive change in 12-month deliveries in square feet, net absorption in square feet, rent growth, and vacancy rates. Businesses have been capitalizing on newfound foot traffic. Also, this holiday season is very special. This is the first time in 2 years Portland will see more in-person shopping with the decrease in COVID-19. While some retail stores stood steady, others thrived during the third quarter. Here I highlight the following trends through the third quarter: the average rents, vacancy rates, new construction (new players), and consumer behavior.

The Quarterly Index took a deep dive into what some retail groups are doing in regards to current inflation heading into the 2022 holiday season. Offline Fitness and Discount & Dollar stores have been thriving in Q3 2022, which is a trend that continued from the previous quarter. Grocery and super stores on the other hand have remained steady. Others that have not been thriving are mall foot traffic and full-service restaurants. Mall foot traffic has seen a slight downturn, while the restaurants have struggled because inflation tightened consumers' budgets.

Discount & Dollar stores have elevated their numbers relative to Q3 2019 and Q3 2021. These Yo3Y (year-over-three-years) and YoY(year-over-year) numbers are great. The Yo3Y foot traffic numbers are up double digits, and the YoY numbers are up 0.8%. These stores are some of the only ones to pass the pre-pandemic numbers. Not many retail sectors are topping the figures that were posted before the pandemic. Pre-pandemic life compared to post-pandemic life for retailers is going to be an ongoing story for a while. Pre-pandemic numbers were hitting highs up until COVID-19.

Vacancy rates ended at 3.6% in the second quarter, slightly above this quarter's rates, which are at 3.5%. Vacancy rates have fluctuated because of COVID-19 in recent years, but we are seeing steady rates nearing the "tail-end" of the pandemic. Portland saw a historical ten-year low of 2.9% in the first quarter of 2019, but since then, vacancy rates have been between 3.3% and 4%.

Malls continue to see the highest vacancy rates in Portland while general retail sees the lowest vacancy rates. The foot traffic is starting to pick up again for malls this quarter as we approach the holiday season. These shopping outlets are seeing some damage still from e-commerce style shopping because COVID-19 forced people to shop online. Portland is starting to see more normal numbers, but we have not yet reached pre-pandemic figures. The retail trade sector employment is indeed seeing a year-over-year change of 2.905 jobs. This is close to 500 more than the previous quarter. People are starting to go back to work in person. Portland is climbing out of a hole because of COVID-19, but it is starting to get smaller and smaller. The city is getting close to pre-pandemic figures.

The average asking rent per square foot has risen again this year. It has continued to be on a steady rise for the past decade. The average asking rent per square foot in 2012 started at around $16 per square foot, and now we are up to around $22 per square foot. The market at least has been steady regarding asking rent. Retail rent growth in Portland has posted gains of 2.3% year-over-year, which is a gain of 0.3% compared to last quarter. The national performance for this metric saw gains of 4.3% year-over-year compared to last quarter's 4.2% year-over-year gain. Portland is seeing elevated leasing activity.

The average rent per square foot for Portland's malls is $23.13 versus the national index of $31.84 per square foot for similar space. The mall space in Portland is secured for a steep discount. The struggles in mall properties in Portland are prevalent. They are not immune to these struggles, and Portland is still trying to find solutions for the problems in the malls.

One example is the Lloyd Center. This mall got hit hard during the riots and the pandemic, and it has not had a strong recovery. It used to be known as one of Portland's premier shopping centers. The Lloyd Center has been repossessed by creditors. The downfall of foot traffic in this area has led to the current owners struggling to meet debt obligations. The future of the Lloyd Center could be partial demolition and new construction for the retail market.

Retail investment activity in Portland has caught a tailwind. The current average pricing is creeping upwards heading into the fourth quarter. The current average pricing is around $253 per square feet.

Post-pandemic annual investment is emerging in the Portland retail market. Usually, Portland sees better investment for multifamily, office, and industrial, but post-pandemic life is allowing investments to thrive in the city. Cap rates have compressed to 6.3% in Portland. Our country's average cap rate is a little higher than Portland's market cap rate.

Retailers across the country have had a heavier focus on smaller retail space during Q3. The average amount leased is approximately 3,000 square feet. The demand for smaller space is heightened by the growth in store counts for quick-service restaurant brands. Some of the popular quick service stores are Starbucks, Crumble Cookies, and Yum brands. Other restaurant brands that have been in the expansion include Popeyes and Firehouse Subs chains. Medium to larger retail spaces are seeing some life from Dollar Tree and Dollar General, along with T.J. Maxx and Burlington. Consumers have eased back into pre-pandemic behaviors allowing these retailers to succeed in Q3.

Leasing activity across the country has been consistent for some time now. This quarter marks the 7th consecutive quarter with positive absorption. Most of the increased demand came from freestanding properties or small retail centers. The positive trend of consistent leasing activity is still seen as an open question. Retail tenants across the country are facing significant cost pressures. The cost pressures are seemingly on every line item and certain costs. Labor and transportation costs don't seem to be dropping anytime soon.

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05

COLUMNS

Economic Analysis

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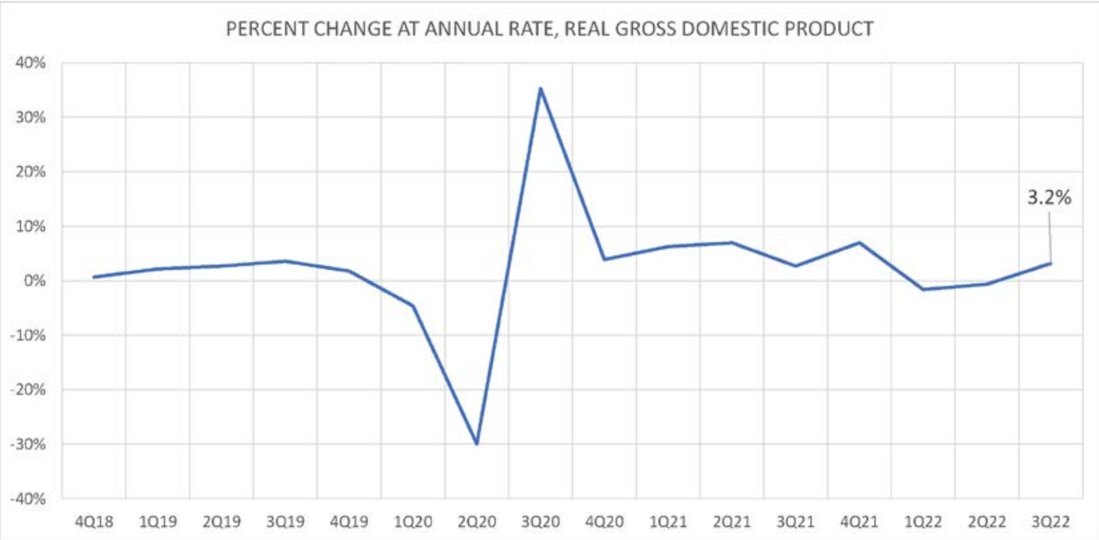
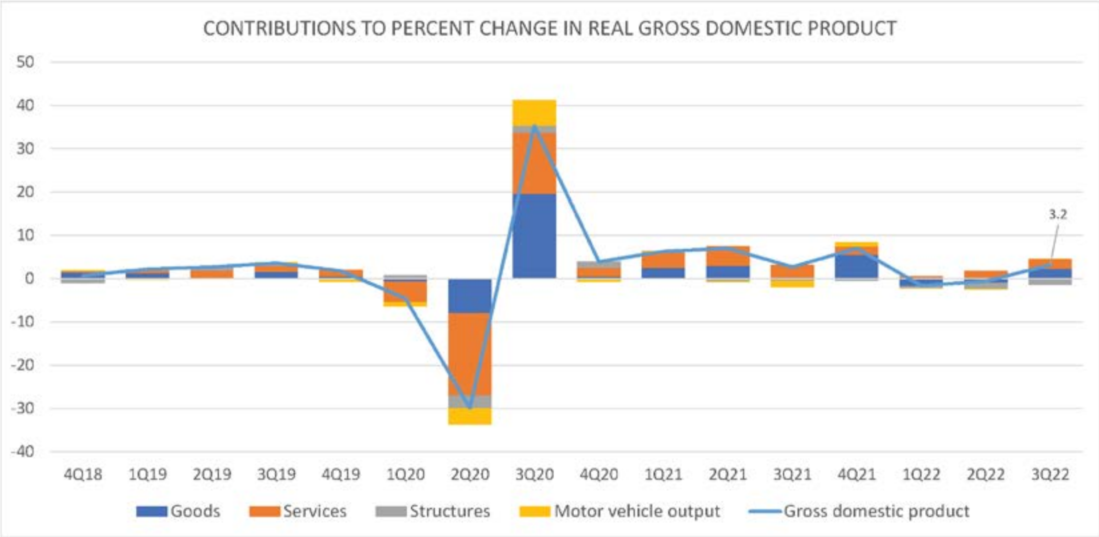
THE NATIONAL ECONOMY expanded at an estimated annualized rate of 3.2% during the third quarter of 2022. This was a welcome sign following the modest declines during the two previous quarters. The increase during the quarter reflects increases in net exports and consumer spending, which continues to be fueled by elevated balance sheets. Housing investment decreased, while profits declined less than 0.1% during the quarter. Private services-producing industries expanded 4.9%, while government ones increased 0.6%. This was offset by declines in private goods-producing industries, with output decreasing 1.3%.

U.S. Bureau of Economic Analysis[1]



U.S. Federal Reserve Bank of St. Louis[2]



The economy is very difficult to assess and forecast at this time, as common indicators are all over the board. Income went up during the recent downturn, while the labor market remains unusually tight despite overall employment being only modestly above pre-pandemic levels. Inflation continues to be a major factor in the economy.

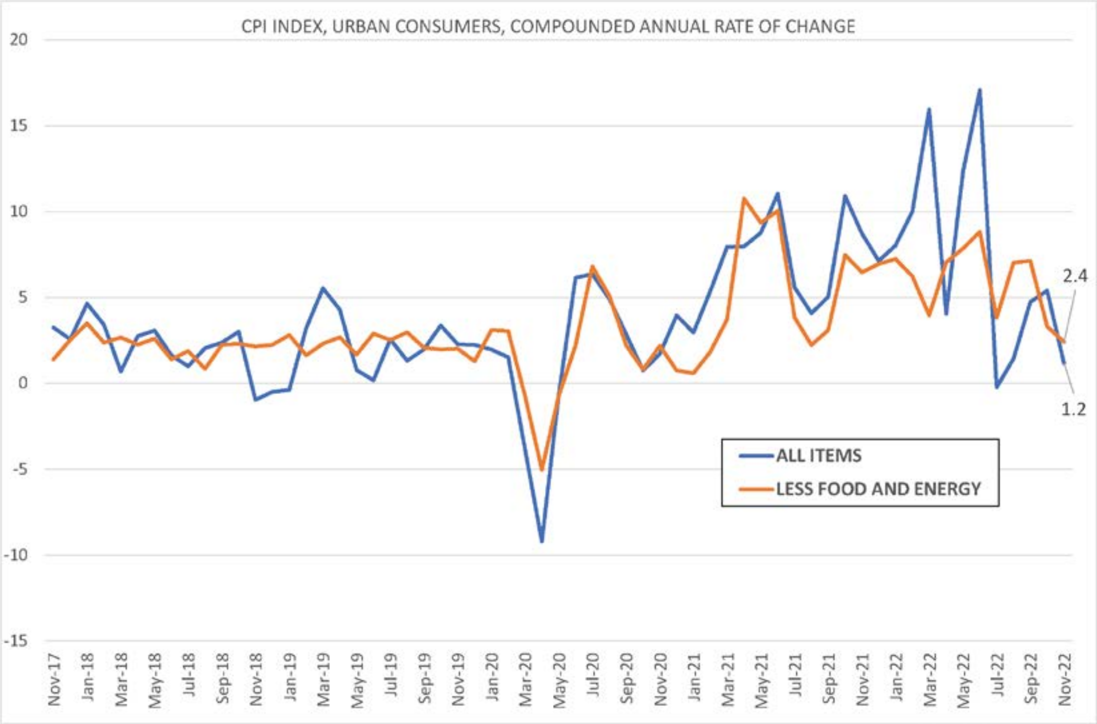
While the pace of economic expansion appears to have reached a more sustainable rate post-pandemic, there are several indicators that are raising significant concerns for short to mid-term economic prospects. The surge in federal stimulus during the pandemic came during a period in which the supply chain was unusually challenged, and the resulting inflationary pressure has emerged as the dominant economic issue.

1 https://www.bea.gov/news/2022/gross-domestic-product-third-estimate-gdp-industry-and-corporate-profits-revised-third

2 https://fred.stlouisfed.org/

The rate of inflation has been slowing significantly over the last several months. While the headline rate for all urban consumers (CPI-U) was 7.1% year over year in November, this was well below the 9.0% rate in June, and the compounded annual rate of change has dropped significantly. We appear to be on the back side of the inflation surge. The tightening by the Federal Reserve has been effective in slowing the economy, but there remains a significant threat that too much tightening will push the economy into a recession in 2023.

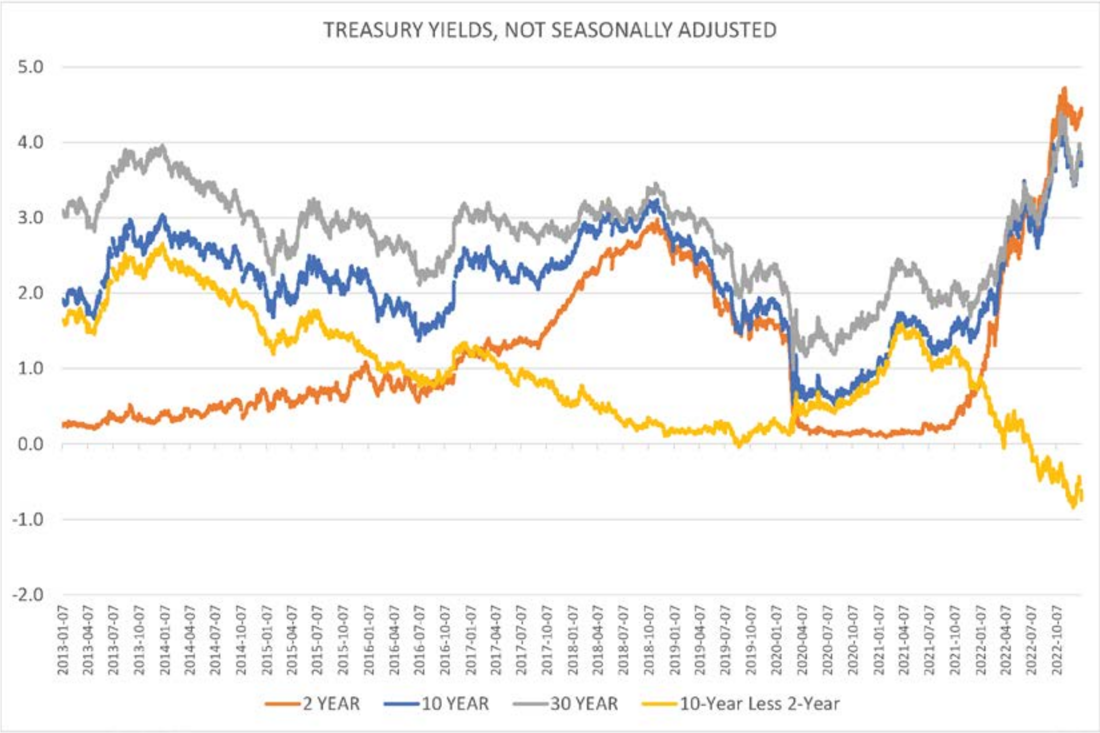
U.S. Federal Reserve Bank of St. Louis



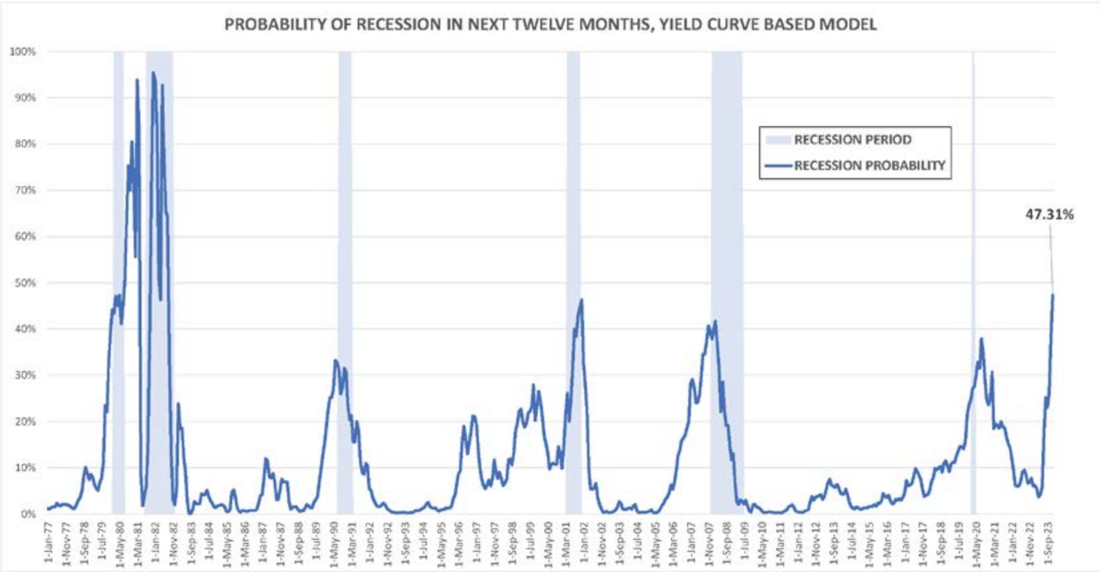
The rapid increase in short-term interest rates associated with Federal Reserve tightening has resulted in an inverted yield curve. Two-year treasury yields are now 50 to 100 basis points higher than ten-year yields. These are typically higher for bonds that mature over longer periods.

An inverted yield curve is often viewed as a leading recession indicator, with an inverted yield curve emerging prior to nearly all recessions since 1960. The Federal Reserve Bank of New York has constructed a model that generates a probability of recession in the next twelve months based on these curves. This model has a strong track record and estimates the probability of recession in 2023 at over 47%.

U.S. Federal Reserve Bank of St. Louis



U.S. Federal Reserve Bank of New York[3]



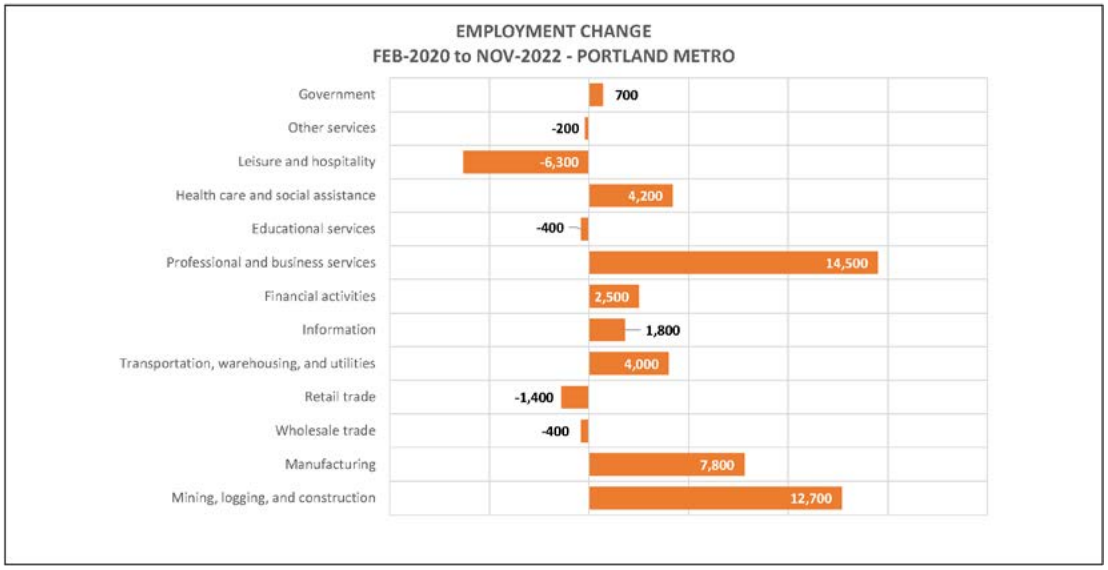
Employment growth in the Portland metropolitan area has remained robust through November, with average employment levels in 2022 over 60,000 jobs higher than the same period in 2021. This rate of expansion is not sustainable and reflects the recovery of lost jobs associated with the pandemic. Overall employment levels are close to the longer term trend line now, and the pace of growth is expected to be more moderate going forward (assuming no national recession). Growth in professional and business services, construction, and manufacturing have seen a strong rebound since the pandemic first impacted employment levels in February of 2020. The region's strength in manufacturing is notable in that this has not been an area of strength at the national level. Growth has been significant in health care and social assistance, but this sector did not see a large pandemic-related decline.

3 https://www.newyorkfed.org/research/capital_markets/ycfaq.html#/

Estimated based on comparison of first eleven months YOY

Oregon Employment Department, Qualityinfo.org[4]

Oregon Employment Department, CES series



The State of Oregon Economist Office's year end Economic and Fiscal Forecast anticipates a mild recession in the first half of 2023, with a decline in Real GDP of 1.1%. Growth is expected to remain below trend in 2024, with the unemployment rate rising to 6.0% by the end of 2023. Inflation is expected to decline to 4.2% in 2023 and then 2.5% in 2024. A consensus has emerged among economists that a recession is likely at the national level in 2023, and the state is expecting to feel its impacts.

An area of recent concern in the State of Oregon is the recent estimated drop in population from July 1, 2021, through July 1, 2022. The overall population was estimated by the Census Bureau to have dropped by 16,164. This reflects a natural decline of 5,089 (births less deaths) as well as a net migration loss of 10,305. While the State was estimated to have attracted over 7,000 international migrants, it lost an estimated 17,000 to domestic migration. Total estimated population growth statewide was just over 2,800 since 2020. These estimates conflict with those from Portland State University's Population Research Center, which estimates a population growth last year of roughly 15,000 (reflecting an annual rate of growth of only 0.35%). PSU's estimates for the Portland metro area counties of Multnomah, Washington, and Clackamas reflected growth of only 2,800 people from 2021-2022, which corresponds to a rate of 0.15%.

4 https://qualityinfo.org/ceest?rt=0&cesCode=00000000&cesArea=4101000000&cesSeasAdj=1&cesSeries=or&cesYear=2019

The City of Portland's well publicized struggles with houselessness, employment losses in the central city, and an erosion of the marketability of the city as a brand may be showing up in migration patterns. A slowing or decreasing rate of population growth, and certainly a decline, impacts the economy and the real estate markets. Our economy is highly reliant upon positive net migration into the state and metro area to support continued economic expansion. The natural rate of growth (births less deaths) has been negligible for decades, but our success in attracting new residents has allowed our economy to expand. Population and household growth also directly fuel the residential markets, while increased buying power drives retail sales.

DEMOGRAPHIC TRENDS

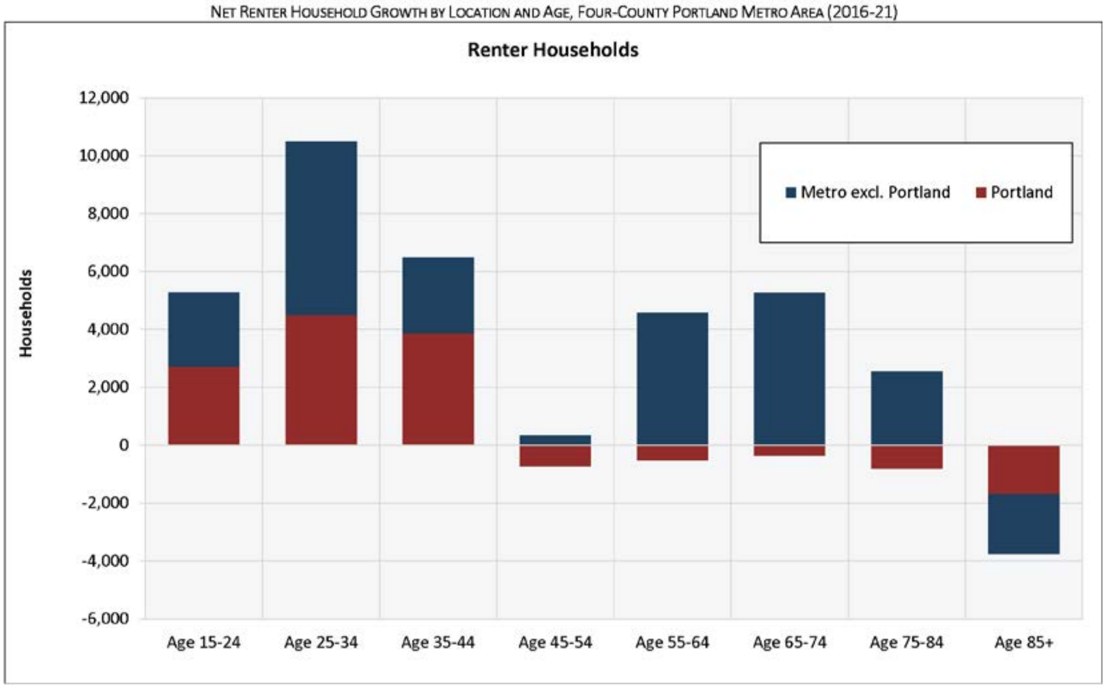
The Census Bureau recently published household estimates for 2021. Of the four major counties in the Portland Metro Area, Multnomah experienced the strongest household growth over the 2016-2021 period, with an increase of 28,000 households. On a net basis, nearly all the growth took place among homeowners, while the renter base barely grew. Clark County had the second largest increase in the region with 24,000 new households, followed by Washington County at 20,000 and Clackamas at 8,000. In Washington County, most of the growth was in the renter segment, while Clackamas saw most of its growth among homeowners, and Clark was nearly evenly split between the two.

If we focus on renters only, three-quarters of the growth took place outside of Portland, which appears to have seen a bit of an exodus of renters above the age of 45. All of Portland's net renter growth took place below this age level, with the 25 to 34 age group accounting for the largest share. The city saw a decline in renters in all age groups above 45. COVID, riots, issues with crime, vandalism, and homelessness likely contributed to these declines.

Portland's rental housing was already dominated by young segments in 2016. The change over the last five years has made the renter base even younger, with renters below the age of 35 making up 43%. In the remainder of the Metro Area, the distribution across age groups is more even, but still with the under-35 age group dominating, accounting for 34%. However, the growth over the past five years has been stronger at ages between 55 and 84 (+12,300) than below 44 (+11,200).

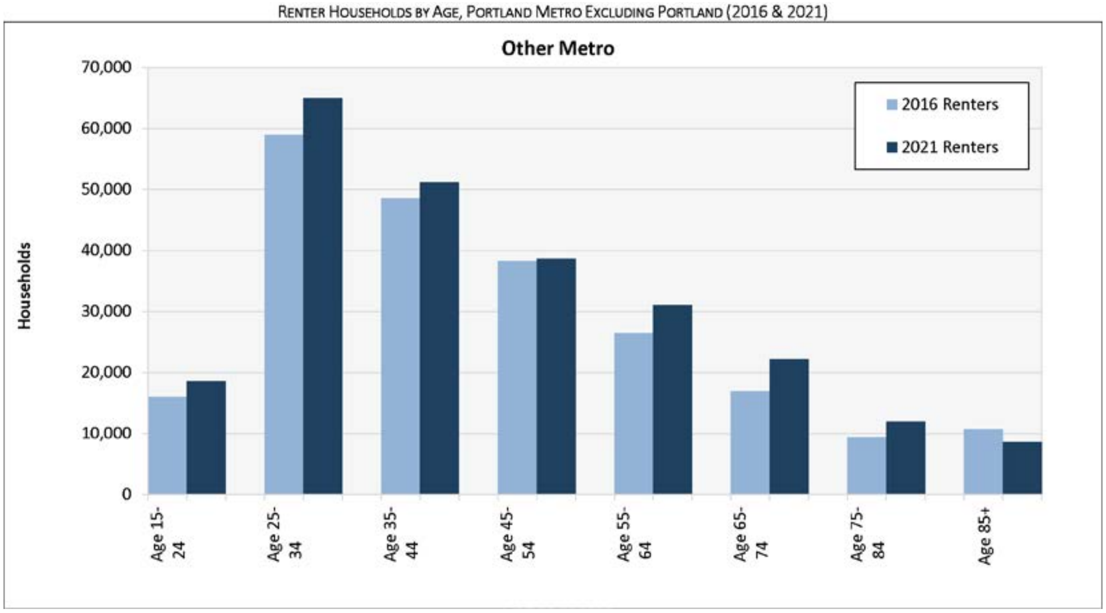
U.S. Census Bureau[5]

Net Renter Household Growth by Location and Age, Four-County Portland Metro Area (2016-21)



U.S. Bureau of Labor Statistics

Renter Households by Age, Portland Metro Excluding Portland (2016 & 2021)



5 https://www.census.gov/data/developers/data-sets/census-microdata-api/acs-5y-pums.html

06

COLUMNS

Rental Market

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In early November, the Federal Reserve Bank announced yet another 0.75% interest rate hike, its fourth consecutive one this year. An attempt to curb inflation, the move further increases the cost of borrowing and debt for Americans across the country.[1] For many economists, sustained rate hikes are a good indication that a recession is on the horizon. While Portland's rental market showed few signs of slowing in the second quarter, an analysis of data from the third quarter suggests that the effects of higher rates have begun to set in. While rents continued to grow and vacancy continued to fall across the Portland metro region, they did so at a much slower rate than during recent periods.

There are ways in which the rental market has benefited from the economic downturn. Median priced homes in the metropolitan area are no longer affordable to households earning the region's median income, in large part due to the increased cost of financing brought on by soaring interest rates. This has created new demand for rentals, which, with a low vacancy rate as evidence, the market has been able to capture.

Despite steady demand, Portland's rental market is not immune to the effects of higher rates. Inflation has drastically increased operational costs for many investors in the Portland market, particularly for investors with older buildings in their portfolios. This has contributed to a significant slowdown in transactions from last quarter. Portland's cap rates continued to fall in the third quarter, albeit slightly. Given that the cap rate is essentially a backward-looking metric captured at a building's sale, it will likely begin to rise in the very near term as sellers in today's market may be forced to lower prices to see deals close.

RENTS AND VACANCY

After a 4.15% increase in the second quarter, market effective rents grew just 0.06% in the third quarter across the Portland metro area. Average rents per square foot remained steady at $1.94. Figure 1 plots effective 12-month rent growth and vacancy between 2010 and 2022. At 5.10%, 12-month effective rent growth is also showing signs of slowing. This is the lowest growth rate since the first quarter of 2021, when rents started rebounding post pandemic. There are signs, however, that rent growth is slowing nationwide. In their October 2022 survey, the National Multifamily Housing Council found that rent growth across 268 real estate firms surveyed is decreasing, and notes that the market is beginning to revert to pre-pandemic trends, largely due to investor uncertainty brought on by increased rates.[2] While the vacancy rate fell from 4.75% in the second quarter to 4.61% in the third quarter, reaching its lowest point since the second quarter of 2015, some economists predict that we will see vacancies begin an upward trend as inflation continues to slow household formation.[3]

1 Winters, Mike. *The Fed announces 4th consecutive 'jumbo' interest rate hike of 75 basis points—here are 4 things that will be more expensive. (2022, Nov 4) CNBC, https://www.cnbc.com/2022/11/02/fed-raises-borrowing-costs-with-another-jumbo-interest-rate-hike.html*

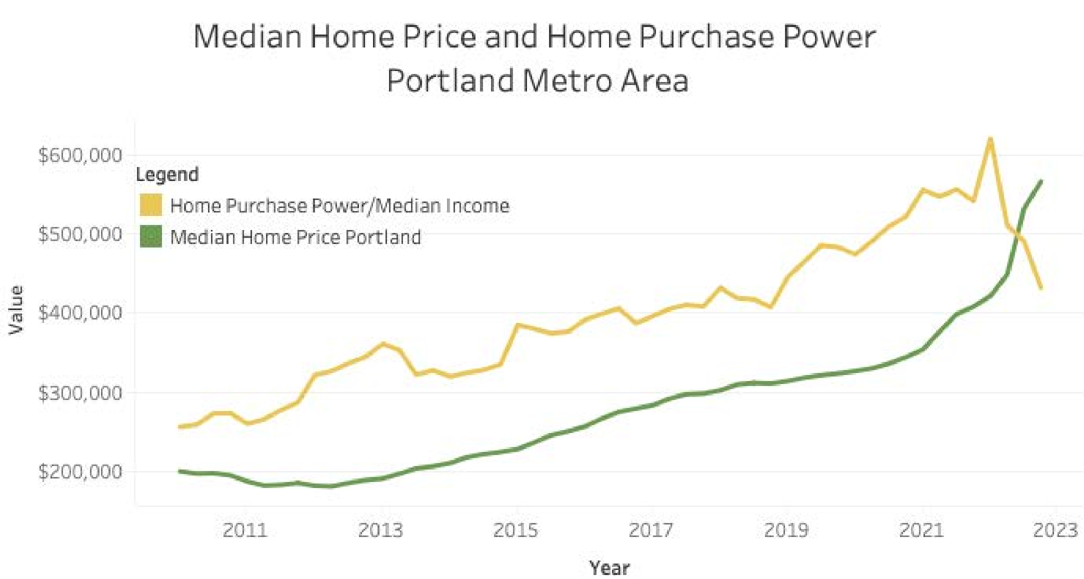
2 Dunn, Colin. *Apartment Market Softens, Sales Put on Hold Amidst Rising Rates and Economic Uncertainty. (2022, Oct 28) National Multifamily Housing Council.*

3 McBride, Bill. *Year-over-year Pace of Rent Increases Continues to Slow. (2022, Oct 31) Calculated Risk Newsletter.*

Figure 1
St. Louis FRED, U.S. Census

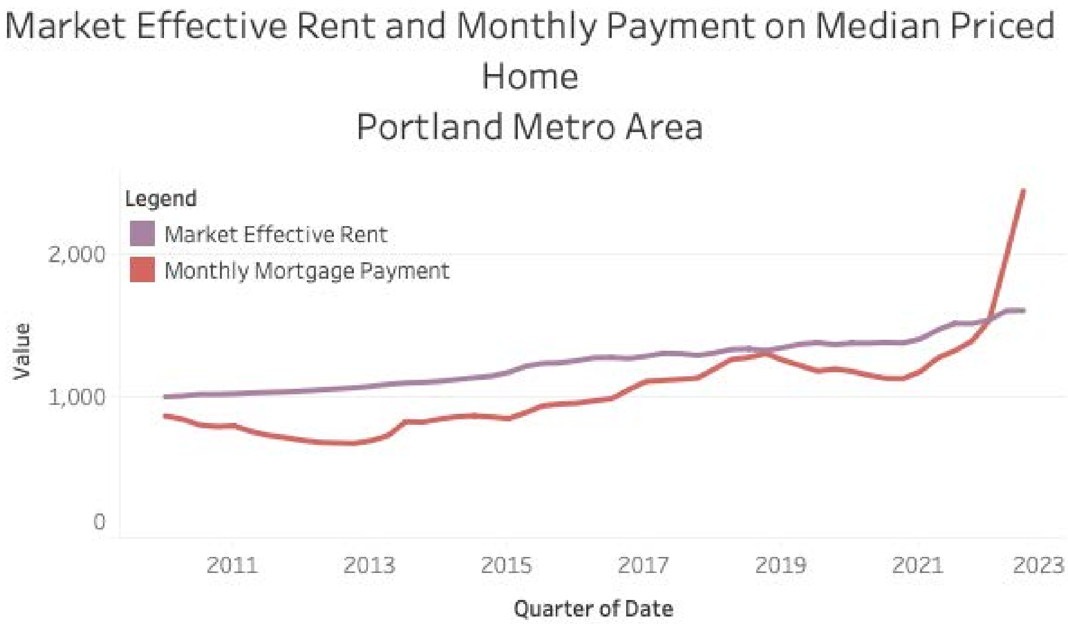
While less than prior periods, positive rent growth and falling vacancy rates suggest that, among other factors, the market may be capturing increased demand as potential homeowners remain in the rental market. With rising interest rates, homeownership is now out of the reach for an increasing number of households in the metro area. Figure 2 depicts the median home price and the home purchase power based on a median income in the Portland metro area from 2010 to 2022. Between the third quarter of 2021 and the third quarter of 2022, the average monthly mortgage payment on a median priced home in Portland increased an astounding 85%, from $1,322 to $2,451. This is the highest monthly payment in the dataset. In the third quarter, for the first time in this dataset, the purchasing power of a household earning a median income fell below the median home price in the Portland metro area. Assuming standard underwriting requirements on a 30-year fixed-rate mortgage, metro area households earning a median income can no longer afford a median price home.

Figure 2
St. Louis FRED, CoStar



For many households, renting in today's market is the only option. This boosts demand for rental products and presents new opportunities for rental increases. Figure 3 plots the market effective rent and the average monthly mortgage payment for a median price home in Portland, assuming an 80% down payment on a 30-year fixed rate loan. Since the first quarter of this year, the monthly mortgage payment on a median priced house in Portland has exceeded the effective monthly rent for the first time in this dataset. With rates still rising, we can expect the upward trend of mortgage payments to continue in the near term.

Figure 3
St. Louis FRED, CoStar



As homeownership slips further out of reach for many residents, we would expect to see some level of continued rent growth through the end of the year and potentially beyond. For many investors and operators, increasing rent is necessary to combat soaring inflation rates. Landlords across the country, particularly those with small to midsize portfolios, are struggling to cover increased operating costs. According to the New York Times, while rents are rising, an inflation-induced spike in wages, property taxes, insurance and maintenance is absorbing much of these rental gains for this segment of landlords. Many are struggling to break even with profit reserves from last year's hot post-pandemic market nearly depleted. This is especially true for smaller players with older buildings in their portfolios. Tenants with higher incomes who seek newer buildings are willing to accept rent increases as a tradeoff for greater amenities. Operators of newer buildings are taking full advantage of this trend as reflected in their rent increases, while those of older buildings have been forced to slow increases to retain lower-income tenants who are bearing the brunt of inflation.[4]

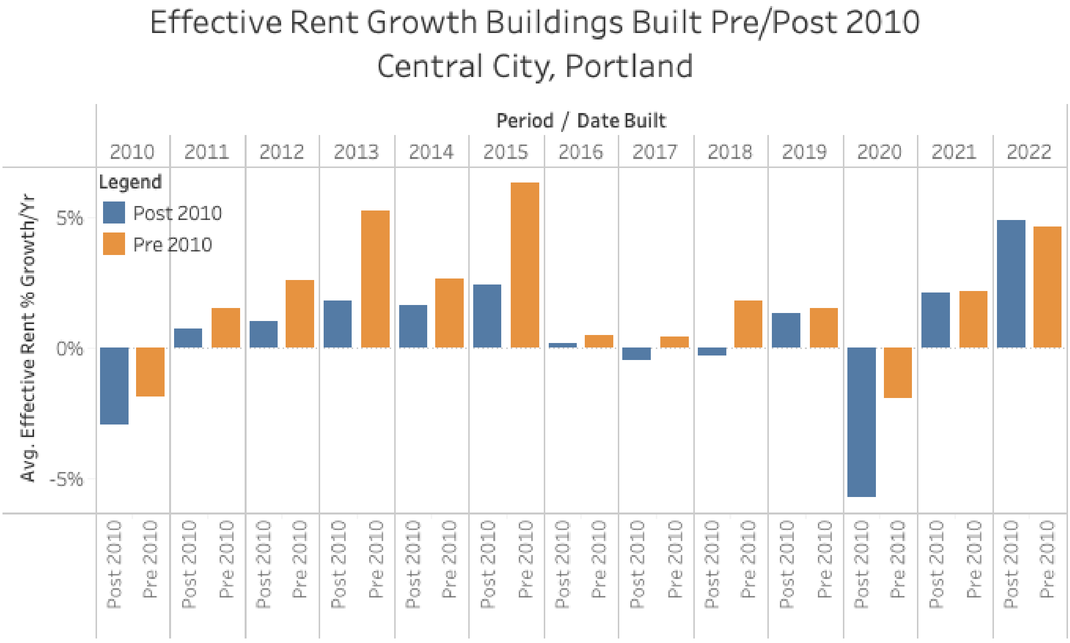
In Portland, small to midsize investors are grappling with inflated costs. According to Steve Rose, CEO of Bristol Urban Apartments, a real estate investment and management company with a portfolio of nearly 1,000 apartment units in Portland and Vancouver, rents alone fall short of covering costs. "Irregardless of statewide rent control and City of Portland rent increases triggers," Rose says, "market rents are not sufficient in covering the across the board increases that we are seeing in operating multifamily properties. Costs for labor, materials, taxes, graffiti removal, and crime prevention have skyrocketed over the past two years." In addition, as a value-add

4 DePillis, Lydia. *Inflation Has Hit Tenants Hard. What About Their Landlords? (2022, Sept 27) The New York Times.*

investor whose portfolio is made up of exclusively vintage, urban properties, Rose says that retaining tenants in this market translates to fewer opportunities for rent increases.[5]

Because newer buildings typically set rents more aggressively when they deliver units to the market, older buildings traditionally have more opportunities for rent increases than newer ones. This trend, however, shows signs of reversing in Portland. Figure 4 depicts effective rent growth for market rate buildings built pre and post 2010 in the central city. In 2022, for the first time in this dataset, buildings that were built post 2010 saw greater effective rent growth than buildings built pre 2010[6]. To compete, newer buildings must price rents in accordance with other new buildings on the market, which usually limits rent growth year over year. This data suggests that renters of newer units in 2022 have been willing to accept rent increases as a tradeoff for greater amenities, and echoes Rose's sentiment that increasing rents in today's market comes at the risk of losing tenants and creating new turnover costs. Whether or not this trend will continue beyond this year as the economy edges towards a recession, it is an interesting one to track given Portland's increasing stock of aging buildings.

Figure 4
CoStar



CAP RATES & SALES ACTIVITY

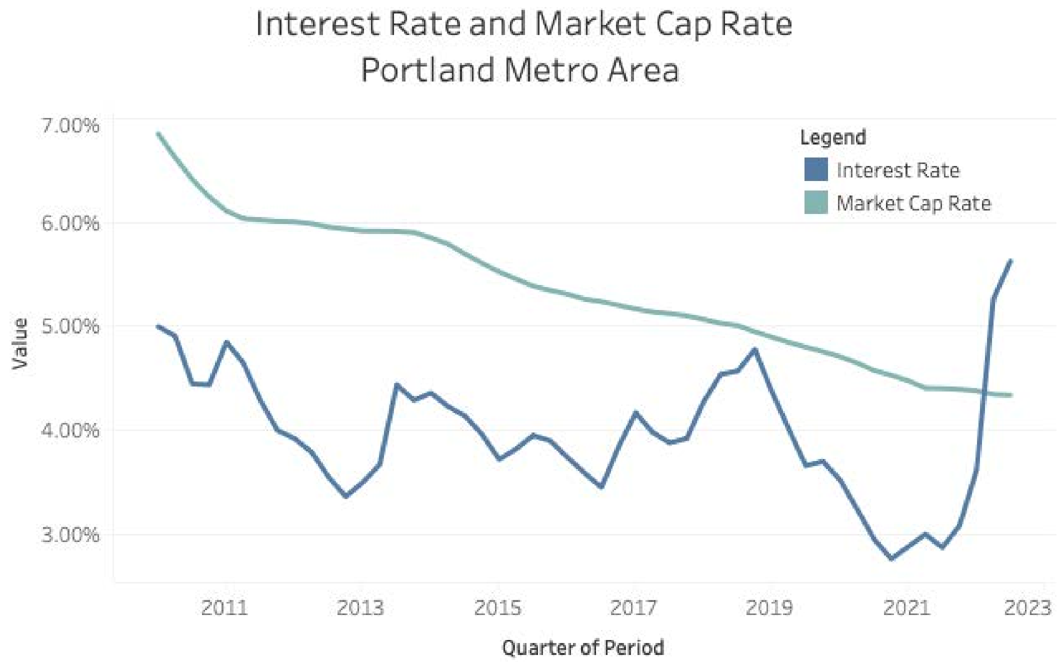
The average market cap rate continued its downward trend over the last quarter, falling from 4.35% to 4.34%. While only a slight decrease, it's clear that cap rates have yet to reflect rising interest rates. Figure 5 plots interest rates and Portland's market cap rate since 2010. While not directly correlated, interest rates and cap rates tend to trend in similar directions. As interest rates rise, increasing the cost of financing, we'd expect cap rates to follow suit. In theory, investors will require greater returns during economic downturns characterized by higher rates. According to Greg Frick, partner at local brokerage HFO Investment Real Estate, Portland's low cap rate over the last several quarters indicates that investors in the city are willing to accept a lower return threshold for a higher building value. As borrowing costs continue to rise and banks begin scaling back the amount of leverage that they are willing to give, cap rates are likely to increase, says Frick.[7]

5 *Steve Rose, interview by author, Portland. Nov 7, 2022.*

6 *This dataset represents aggregate data. A more accurate analysis of rent growth by building date requires building-level data*

7 *Greg Frick, interview by author, Portland. Nov 2, 2022.*

Figure 5
St. Louis FRED, CoStar



Another likely reason that cap rates have yet to react to raising interest rates is related to the fact that the cap rate is closely tied to transactions. Sales volume fell nearly 50% from the second quarter to the third quarter in Portland, with just sixty six transactions totaling $491.8 million. In addition, the average sales price per unit fell from $282,487 in the second quarter to $253,524 in the third quarter. According to Frick, brokers are seeing multifamily deals sit on the market longer or getting pulled off the market altogether. There is a disconnect between the bid-ask spread. Private investors must be willing to come in with more equity, but are cautious to do so due to substantial increases in operational costs. As noted, Portland's stock of aging buildings is increasing. Private investors must decide if they want to invest substantial amounts of cash to fix and maintain these buildings. Heightened inflation is challenging the overall willingness to invest. Institutional investment has also flattened over the last quarter due to lower yield-based returns as many sellers remain unwilling to adjust prices despite borrowing costs continuing to increase.[8] Once sellers are forced or willing to accept lower prices for their buildings, cap rates will go up.

LOOKING FORWARD

As the economy edges towards a recession, fewer transactions and less opportunities for rental gains will cause the rental market in Portland to continue to slow in the near term, largely due to increased interest and inflation rates. Rental growth and vacancy began to show signs of stabilizing in the third quarter. While the market benefited from increased rental demand due to the rising cost of homeownership, inflation and subsequent cost increases have largely eaten up post-pandemic rental gains for many local investors. Because high financing costs require investors to raise more equity, transactions slowed significantly in the third quarter. As transactions from the third and fourth quarters are finalized and captured, we should see cap rates start to rise heading into the new year.

While a recession feels imminent, the economy continues to show signs of resiliency and even growth. Jobs continue to be added, hiring remains strong, and the unemployment rate fell from 3.7% to 3.5% in September.[9] Whether or not this

8 Greg Frick, interview by author, Portland. Nov 2, 2022.

9 Zahn, Max. US economy grew significantly in 3rd quarter, ending six months of shrinking. (2022, Oct 27) ABC News, https://abcnews.go.com/Business/us-economy-expected-grown-significantly-ending-months-shrinking/story?id=92133670 growth will be enough to avert a recession, it is still a positive reflection of our current economic state. Even as the rental market shows signs of slowing in Portland, the upside of rental investments during economic downturns remains high.

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